Internal Revenue
bulletin

Bulletin No. 2002–29
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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. 2002–47, page 119.
LIFO; price indexes; department stores. The May 2002 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, May 31, 2002.

T.D. 9002, page 120.
Final regulations under section 1502 of the Code revise rules concerning the common parent as agent for a consolidated group, including the term and scope of the common parent's authority as agent, the designation of a substitute agent by a terminating common parent, the existence of a default substitute agent under certain conditions, the designation of a substitute agent by the Commissioner under certain circumstances, and the filing of a tentative carryback adjustment with respect to a loss from a separate return year.

Notice 2002–51, page 131.
This notice solicits public comments on the application of section 142(a)(6) of the Code, which permits tax-exempt bonds to be issued to finance solid waste disposal facilities.

Rev. Proc. 2002–50, page 173.
This procedure states that if an individual exercises a statutory or nonstatutory stock option and sells the stock on the same day as the exercise, the sale constitutes an "excepted sale" for Form 1099–B reporting under section 1.6045–1(c)(3)(ii) of the regulations, provided certain conditions are satisfied.

Rev. Proc. 2002–51, page 175.
Specifications are set forth for the private printing of paper substitutes for the December 2001 revisions of Form W–2c, *Corrected Wage and Tax Statement*, and Form W–3c, *Transmittal of Corrected Wage and Tax Statements*. Rev. Proc. 95–18 superseded.

EMPLOYEE PLANS

Rev. Rul. 2002–45, page 116.
Restorative payments; nondiscrimination; deductions; qualified defined contribution plan. This ruling describes two situations in which certain payments, which are termed "restorative payments" in the ruling, to a qualified defined contribution plan are not treated as contributions for purposes of various sections of the Code.

Rev. Rul. 2002–46, page 117.
Deductibility; timing. Contributions made during a grace period to a section 401(k) plan or as matching contributions to a qualified defined contribution plan are not deductible by the employer for a taxable year if the contributions are attributable to compensation earned by plan participants after the end of that taxable year. Rev. Proc. 2002–9 modified and amplified.

Notice 2002–48, page 130.
Deductibility of contributions; timing. This notice provides that the Service will not challenge the deductibility of certain contributions actually made during the taxable year in anticipation of section 401(k) deferrals and section 401(m) matching contributions.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

Notice 2002–49, page 130.
Weighted average interest rate update. The weighted average interest rate for July 2002 and the resulting permissible range of interest rates used to calculate current liability for purposes of the full funding limitation of section 412(c)(7) of the Code are set forth.

Rev. Proc. 2002–47, page 133.
Administrative programs; closing agreements. This procedure updates and expands upon the Service's correction programs for retirement plans within the jurisdiction of the Commissioner, Tax Exempt and Government Entities Division. Rev. Proc. 2001–17 modified and superseded.

EXEMPT ORGANIZATIONS

Announcement 2002–66, page 183.
A list is provided of organizations now classified as private foundations.

EMPLOYMENT TAX

Rev. Proc. 2002–51, page 175.
Specifications are set forth for the private printing of paper substitutes for the December 2001 revisions of Form W–2c, *Corrected Wage and Tax Statement*, and Form W–3c, *Transmittal of Corrected Wage and Tax Statements*. Rev. Proc. 95–18 superseded.

EXCISE TAX

Announcement 2002–65, page 182.
This document contains corrections to proposed regulations (REG–209114–90, 2002–9 I.R.B. 576) under section 280G of the Code that provide guidance about the denial of the deduction to a corporation for any excess golden parachute payment to certain individuals.

ADMINISTRATIVE

T.D. 9001, page 128.
Final regulations under section 6103 of the Code permit IRS to disclose an additional item of return information to the Department of Agriculture for its use in structuring, preparing, and conducting the Census of Agriculture. The additional item consists of the taxpayer's telephone number provided on Form 1040 (Schedule F).

Rev. Proc. 2002–49, page 172.
Stranded costs. This procedure provides that investor-owned utilities will not realize gross income upon the securitization and transfer of a statutorily created intangible property right to collect charges from their customers to cover stranded costs caused by restructuring of the electrical utility industry.

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

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 consolidated 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 first 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 first Bulletin of the succeeding semiannual period, respectively.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

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

Section 103.—Interest on State and Local Bonds

The Service solicits public comments on the application of section 142(a)(6) to tax-exempt bonds which finance solid waste recycling facilities. See Notice 2002–51, page 131.

Section 142.—Exempt Facility Bond

The Service solicits public comments on the application of section 142(a)(6), which permits tax-exempt bonds to be issued to finance solid waste disposal facilities. See Notice 2002–51, page 131.

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

Will the Service challenge the deductibility of certain contributions actually made during the taxable year in anticipation of section 401(k) deferrals and section 401(m) matching contributions? See Notice 2002–48, page 130.

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26 CFR 1.401–1: Qualified pension, profit-sharing, and stock bonus plans.
(Also §§ 404, 415, 4972; 1.415–6.)

Rev. Rul. 2002–45

Restorative payments; nondiscrimination; deductions; qualified defined contribution plan. This ruling describes two situations in which certain payments, which are termed "restorative payments" in the ruling, to a qualified defined contribution plan are not treated as contributions for various sections of the Code.

ISSUE

Under the facts described below, are payments to the trust of a defined contribution plan qualified under § 401(a) of the Internal Revenue Code (the Code) treated as contributions for purposes of § 401(a)(4), 401(k)(3), 401(m), 404, 415(c), or 4972?

FACTS

Situation 1. Employer M maintains Plan X, a defined contribution plan, for the benefit of M's employees. The plan is qualified under § 401(a). Employer M caused an unreasonably large portion of the assets of Plan X to be invested in Entity G, a high-risk investment. It is later determined that the investment has become worthless.

A group of participants in Plan X files a suit against Employer M alleging a breach of fiduciary duty in connection with the investment in Entity G. Following the filing of the suit, the parties agree to a settlement pursuant to which Employer M does not admit that a breach of fiduciary duty occurred but makes a payment to Plan X equal to the amount of the losses (including an appropriate adjustment to reflect lost earnings) to Plan X from the investment in Entity G. The settlement also provides that the payment will be allocated among the individual accounts of all of the participants and beneficiaries in proportion to each account's investment in Entity G over the appropriate period. The court approves the settlement and enters a consent order. Employer M makes the payment to Plan X and the payment is allocated to the appropriate accounts.

Situation 2. The facts are the same as in Situation 1, except that no lawsuit is filed against Employer M. However, Employer M becomes aware that participants in Plan X are concerned about the investment in Entity G and are considering taking legal action. Employer M also learns that lawsuits alleging fiduciary breach have been filed against other companies by those companies' employees over losses to their qualified retirement plans due to investment in Entity G. Employer M decides to make the payment to Plan X before a lawsuit is filed, after reasonably determining that it has a reasonable risk of liability for breach of fiduciary duty based on all of the relevant facts and circumstances.

LAW AND ANALYSIS

The provisions of the Code that apply to contributions to qualified defined contribution plans include §§ 401(a)(4), 401(k)(3), 401(m), 404, 415 and 4972.

Section 401(a)(4) generally provides that the contributions or benefits provided under a qualified defined contribution plan may not discriminate in favor of highly compensated employees. Whether contributions under a defined contribution plan are discriminatory is generally determined by comparing the amount of contributions allocated to the accounts of highly compensated employees with the amount of contributions allocated to the accounts of nonhighly compensated employees.

Section 401(k)(3) contains participation and nondiscrimination standards for elective deferrals to qualified cash or deferred arrangements. Section 401(m) contains nondiscrimination tests for matching contributions and employee contributions. Both § 401(k)(3) and § 401(m) provide rules regarding qualified matching contributions and qualified nonelective contributions.

Section 404 generally provides that contributions paid by an employer to or under a plan, if they would otherwise be deductible, are only deductible under § 404, subject to various limitations under § 404(a).

Section 415(c) generally limits the amount of contributions and other additions under a qualified defined contribution plan with respect to a participant for any year.

Section 4972(a) imposes a 10 percent excise tax on the amount of the nondeductible contributions made to any "qualified employer plan," including a plan qualified under § 401(a) or 403(a).

A payment made to a qualified defined contribution plan is not treated as a contribution to the plan, and accordingly is not subject to the Code provisions described above, if the payment is made to restore losses to the plan resulting from actions by a fiduciary for which there is a reasonable risk of liability for breach of a fiduciary duty under Title I of the Employee Retirement Income Security Act of 1974 (ERISA) and plan participants who are similarly situated are treated similarly with respect to the payment. For purposes of this revenue ruling, these payments are referred to as "restorative payments."

The determination of whether a payment to a qualified defined contribution plan is treated as a restorative payment,

rather than as a contribution, is based on all of the relevant facts and circumstances. As a general rule, payments to a defined contribution plan are restorative payments for purposes of this revenue ruling 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 breach of fiduciary duty. In contrast, payments made to a plan to make up for losses due to market fluctuations and that are not attributable to a fiduciary breach are generally treated as contributions and not as restorative payments. In no case will amounts paid in excess of the amount lost (including appropriate adjustments to reflect lost earnings) be considered restorative payments. Furthermore, payments that result in different treatment for similarly situated plan participants are not restorative payments. The failure to allocate a share of the payment to the account of a fiduciary responsible for the losses does not result in different treatment for similarly situated participants.

Payments to a plan made pursuant to a Department of Labor (DOL) order or court-approved settlement to restore losses to a qualified defined contribution plan on account of a breach of fiduciary duty generally are treated as having been made on account of a reasonable risk of liability.[1]

In no event are payments required under a plan or necessary to comply with a requirement of the Code considered restorative payments, even if the payments are delayed or otherwise made in circumstances under which there has been a breach of fiduciary duty. Thus, for example, while the payment of delinquent elective deferrals or employee contributions is part of an acceptable correction under the VFC Program, such payment is not a restorative payment for purposes of this revenue ruling. Similarly, payments made under the Employee Plans Compliance Resolution System (EPCRS), Rev. Proc. 2002–47, on page 133, of this Bulletin, or otherwise, to correct qualification failures are generally considered contributions and do not constitute restorative payments for purposes of this revenue ruling. However, the payment of appropriate adjustments to reflect lost earnings required under EPCRS is generally treated in the same manner as a restorative payment.

In Situation 1, the payment by Employer M to restore losses to Plan X on account of the investment in Entity G is made pursuant to a court-approved settlement of the suit filed against it by plan participants and is not in excess of the amount lost (including appropriate adjustments to reflect lost earnings). In Situation 2, the payment by Employer M is made after it reasonably determines, based on all of the relevant facts and circumstances, that it has a reasonable risk of liability for breach of fiduciary duty even though no suit has yet been filed. In reaching this determination, the following facts are taken into account: that Entity G was a high-risk investment, that a large portion of the plan assets had been invested in Entity G, that participants expressed concern about the investment, and that several lawsuits had been filed against other employers alleging fiduciary breach in connection with the investment of plan assets in Entity G.

In both Situation 1 and Situation 2, therefore, the payment is made based on a reasonable determination that there is a reasonable risk of liability for breach of fiduciary duty and to restore losses to the plan. In addition, the payment is allocated among the individual accounts of the participants and beneficiaries in proportion to each account's investment in Entity G so that similarly situated participants are not treated differently.

In both Situation 1 and Situation 2, the payment is a restorative payment (as defined in this revenue ruling) and, as such, is not a contribution to a qualified plan. Accordingly, the payment is not taken into account under § 401(a)(4) or 415(c) or, if applicable to the plan, § 401(k)(3) or (m). In addition, the restorative payments to Plan X are not subject to the provisions of § 404 or 4972.

HOLDING

The payments to the defined contribution plans qualified under § 401(a) under the facts described in Situation 1 and Situation 2 above are not contributions for purposes of § 401(a)(4), 401(k)(3), 401(m), 404, 415(c), or 4972.

Drafting Information

The principal author of this revenue ruling is Diane S. Bloom of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, please contact the Employee Plans' taxpayer assistance telephone service at 1–877–829–5500 (a toll-free number), between the hours of 8:00 a.m. and 6:30 p.m. Eastern time, Monday through Friday. Ms. Bloom may be reached at 1–202–283–9888 (not a toll-free number).

Section 404.—Deduction for Contributions of an Employer to an Employees' Trust or Annuity Plan and Compensation Under a Deferred-Payment Plan

Whether "restorative payments" to a qualified defined contribution plan are deductible contributions. See Rev. Rul. 2002–45, page 116.

Will the Service challenge the deductibility of certain contributions actually made during the taxable year in anticipation of section 401(k) deferrals and section 401(m) matching contributions? See Notice 2002–48, page 130.

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[1] Whether a payment is made under the Voluntary Fiduciary Correction (VFC) Program established by the DOL may be taken into account in determining whether there is a reasonable risk of liability. Final rules describing the VFC Program were issued by the DOL on March 28, 2002 (67 **Fed. Reg.** 15062). The VFC Program is designed to encourage employers to voluntarily comply with Title I of ERISA by correcting certain violations of the law. If an applicant meets the VFC Program criteria it will receive a no action letter from the DOL, pursuant to which the DOL will neither initiate a civil investigation under ERISA regarding the applicant's responsibility for any transaction described in the letter nor assess a civil penalty under section 502(l) of ERISA on the correction amount paid to the plan or its participants.

Deductibility; timing. Contributions made during a grace period to a section 401(k) plan or as matching contributions to a qualified defined contribution plan are not deductible by the employer for a taxable year if the contributions are attributable to compensation earned by plan participants after the end of that taxable year.

Rev. Rul. 2002–46

ISSUE

Whether contributions made during the § 404(a)(6) grace period to a qualified cash or deferred arrangement within the meaning of § 401(k) or to a defined contribution plan as matching contributions within the meaning of § 401(m) are deductible by an employer for a taxable year, if the contributions are designated as satisfying a liability established before the end of that taxable year but are attributable to compensation earned by plan participants after the end of that taxable year.

FACTS

Corporation M maintains Plan X, which consists of a qualified cash or deferred arrangement within the meaning of § 401(k) and which also provides for matching contributions within the meaning of § 401(m). M's taxable year is the fiscal year ending June 30. Plan X has a calendar plan year. Plan X was amended to provide for M's Board of Directors to set a minimum contribution for a plan year, to be allocated first toward elective deferrals and matching contributions, with any excess to be allocated to participants as of the end of the plan year in proportion to compensation earned during the plan year. Pursuant to this plan amendment, M's Board of Directors adopted a resolution on June 15, 2001, setting a minimum contribution of $8,000,000 for the 2001 calendar plan year. By December 31, 2001 (the last day of Plan X's 2001 calendar plan year), M had contributed $8,000,000 to Plan X in accordance with the terms of the plan. These amounts consisted of (a) $3,800,000 for elective deferrals and matching contributions attributable to compensation earned by plan participants before the end of M's taxable year ending June 30, 2001 (Pre-Year End Service Contributions), and (b) $4,200,000 for elective deferrals and matching contributions attributable to compensation earned by plan participants after the end of M's taxable year ending June 30, 2001 (Post-Year End Service Contributions). M made each contribution attributable to compensation earned during each pay period contemporaneously with the issuance of wage payments for the pay period.

M received an extension of time to March 15, 2002, to file the income tax return for its taxable year ending June 30, 2001 (2001 Taxable Year). On the income tax return for its 2001 Taxable Year, which was timely filed on March 1, 2002, M claimed a deduction for the entire $8,000,000 for elective deferrals and matching contributions made to Plan X during Plan X's 2001 calendar plan year, relating to both Pre-Year End Service Contributions and Post-Year End Service Contributions. The total amount contributed and claimed by M as a deduction did not exceed 15 percent of the total compensation otherwise paid or accrued during M's 2001 Taxable Year to participants under Plan X (and thus did not exceed the applicable percentage limitation for that year under § 404(a)(3)(A)(i)).

LAW AND ANALYSIS

Section 404(a) provides in relevant part that if contributions are paid to a profit-sharing or stock bonus plan and are otherwise deductible under chapter 1 of the Code, those contributions are deductible under § 404 (subject to certain limitations) in the taxable year of the employer when paid, and are not deductible under any other section of chapter 1 of the Code.

Section 404(a)(6) provides in relevant part that, for this purpose, "a taxpayer shall be deemed to have made a payment on the last day of the preceding taxable year if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof)."

Rev. Rul. 90–105, 1990–2 C.B. 69, applies § 404(a)(6), as interpreted by Rev. Rul. 76–28, 1976–1 C.B. 106, to a situation involving a contribution to a 401(k) plan made after the end of the plan year. Rev. Rul. 90–105 holds that contributions to a qualified cash or deferred arrangement within the meaning of § 401(k) or to a defined contribution plan as matching contributions within the meaning of § 401(m) are not deductible by the employer for a taxable year, if the contributions are attributable to compensation earned by plan participants after the end of that taxable year. *See also* Rev. Rul. 76–28 (providing that a contribution made after the close of an employer's taxable year will be deemed to have been made on account of the preceding taxable year under § 404(a)(6) if, among other conditions, the payment is treated by the plan in the same manner as the plan would treat a payment actually received on the last day of such preceding taxable year of the employer) and *Lucky Stores, Inc. v. Commissioner*, 153 F.3d 964 (9th Cir. 1998), *cert. denied*, 526 U.S. 1111 (1999) (indicating, in the context of a defined benefit plan, that the plain meaning of § 404(a)(6) precludes deduction in the preceding taxable year of grace period contributions that are required under collective bargaining agreements for work performed after the end of that preceding taxable year).

The facts in this revenue ruling are the same as the facts in Rev. Rul. 90–105, except for the addition of the plan amendment and the board resolution setting a minimum contribution for the plan year. These factual differences do not change the result. The plan amendment and the board resolution setting a minimum contribution for the plan year establish a liability, prior to the end of M's taxable year, to make that contribution. However, M's Post-Year End Service Contributions still are attributable to compensation earned by plan participants after the end of the taxable year. Neither the plan amendment nor the board resolution bear on when that compensation is earned. Thus, for example, the Post-Year End Service Contributions in these circumstances are still on account of that subsequent taxable year rather than on account of M's 2001 Taxable Year, and so cannot be deemed paid at the end of M's 2001 Taxable Year under § 404(a)(6). Therefore, the holding of Rev. Rul. 90–105

applies to the facts of this revenue ruling, and M's Post-Year End Service Contributions are not deductible for M's 2001 Taxable Year.

HOLDING

Grace period contributions to a qualified cash or deferred arrangement within the meaning of § 401(k) or to a defined contribution plan as matching contributions within the meaning of § 401(m) are not deductible by the employer for a taxable year, if the contributions are attributable to compensation earned by plan participants after the end of that taxable year. This holding applies regardless of whether the employer's liability to make a minimum contribution is fixed before the close of that taxable year.

APPLICATION

A change in a taxpayer's treatment of contributions to a method consistent with this revenue ruling is a change in method of accounting to which §§ 446 and 481 apply. A taxpayer that wants to change its treatment of contributions to a method consistent with this revenue ruling must follow the automatic change in method of accounting provisions in Rev. Proc. 2002–9, 2002–3 I.R.B. 327 (as modified by Rev. Proc. 2002–19, 2002–13 I.R.B. 696, and as modified and clarified by Announcement 2002–17, 2002–8 I.R.B. 561), with the following modifications:

(1) The scope limitations in section 4.02 of Rev. Proc. 2002–9 do not apply, provided the taxpayer's method of accounting for contributions addressed in this revenue ruling is not an issue under consideration for taxable years under examination, within the meaning of section 3.09(1) of Rev. Proc. 2002–9, at the time the Form 3115 is filed with the national office.

(2) To assist the Service in processing changes in method of accounting under this revenue ruling, and to ensure proper handling, section 6.02(4)(a) of Rev. Proc. 2002–9 is modified to require that a Form 3115 filed under this revenue ruling include the statement: "Automatic Change Filed Under Rev. Rul. 2002–46." This statement should be legibly printed or typed on the appropriate line on any Form 3115 filed under this revenue ruling.

EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–9 is modified and amplified to include in the APPENDIX a change to a method consistent with this revenue ruling.

LISTED TRANSACTIONS

The transaction described in this revenue ruling is substantially similar to the transaction described in Rev. Rul. 90–105, 1990–2 C.B. 69. Under Notice 2000–15, 2000–1 C.B. 826, and Notice 2001–51, 2001–34 I.R.B. 190, transactions that are the same as or substantially similar to transactions described in that notice (including transactions described in Rev. Rul. 90–105) are tax avoidance transactions and are identified as "listed transactions" for purposes of § 1.6011–4T(b)(2) of the Temporary Income Tax Regulations and § 301.6111–2T(b)(2) of the Temporary Procedure and Administration Regulations. Those provisions impose certain requirements on taxpayers that participate in listed transactions, and on promoters of listed transactions.

ALTERNATIVE RATIONALE IN REV. RUL. 90–105

An alternative rationale in Rev. Rul. 90–105 was based upon language in § 1.404(a)–1(b) of the Income Tax Regulations requiring that contributions be compensation for services actually rendered. As indicated in Notice 2002–48, elsewhere in this bulletin, the Service has concluded upon further consideration that this language is relevant only where the reasonableness of an employee's compensation is in question, and thus is not an appropriate basis upon which to determine the timing of deductions for the contributions described in Notice 2002–48, Rev. Rul. 90–105, or this revenue ruling.

DRAFTING INFORMATION

The principal authors of this revenue ruling are James E. Holland, Jr., of the Employee Plans, Tax Exempt and Government Entities Division and John Richards of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact the Employee Plans taxpayer assistance telephone service at 1–877–829–5500 (a toll-free number) between the hours of 8:00 a.m. and 4:00 p.m., Eastern Time, Monday through Friday. Mr. Holland's telephone number is (202) 283–9699 (not a toll-free call). Mr. Richards's telephone number is (202) 622–6090 (not a toll-free call).

Section 415.—Limitations on Benefits and Contributions Under Qualified Plans

26 CFR 1.415–6: Limitation for defined contribution plans.

Whether "restorative payments" to a qualified defined contribution plan are annual additions. See Rev. Rul. 2002–45, page 116.

Section 472.—Last-in, First-out Inventories

26 CFR 1.472–1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The May 2002 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, May 31, 2002.

Rev. Rul. 2002–47

The following Department Store Inventory Price Indexes for May 2002 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, May 31, 2002.

The Department Store Inventory Price Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups — soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE
INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100, unless otherwise noted)

Groups	May 2001	May 2002	Percent Change from May 2001 to May 2002[1]
1. Piece Goods	491.2	490.1	-0.2
2. Domestics and Draperies	598.8	586.9	-2.0
3. Women's and Children's Shoes	653.9	647.5	-1.0
4. Men's Shoes	889.7	924.6	3.9
5. Infants' Wear	625.4	614.9	-1.7
6. Women's Underwear	570.4	542.9	-4.8
7. Women's Hosiery	352.0	345.4	-1.9
8. Women's and Girls' Accessories	553.1	558.0	0.9
9. Women's Outerwear and Girls' Wear	394.6	386.7	-2.0
10. Men's Clothing	595.5	597.7	0.4
11. Men's Furnishings	619.2	602.1	-2.8
12. Boys' Clothing and Furnishings	497.1	495.5	-0.3
13. Jewelry	934.7	901.3	-3.6
14. Notions	776.3	797.6	2.7
15. Toilet Articles and Drugs	947.8	975.0	2.9
16. Furniture and Bedding	641.8	626.4	-2.4
17. Floor Coverings	623.7	620.1	-0.6
18. Housewares	767.1	758.4	-1.1
19. Major Appliances	224.3	220.7	-1.6
20. Radio and Television	54.7	50.4	-7.9
21. Recreation and Education[2]	90.2	86.9	-3.7
22. Home Improvements[2]	125.7	125.4	-0.2
23. Auto Accessories[2]	108.9	110.9	1.8
Groups 1 – 15: Soft Goods	594.0	586.0	-1.3
Groups 16 – 20: Durable Goods	423.0	413.1	-2.3
Groups 21 – 23: Misc. Goods[2]	98.6	96.8	-1.8
Store Total[3]	530.8	522.3	-1.6

[1] Absence of a minus sign before the percentage change in this column signifies a price increase.
[2] Indexes on a January 1986=100 base.
[3] The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Michael Burkom of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Burkom at (202) 622–7718 (not a toll-free call).

Section 1502.—Regulations

26 CFR 1.1502–77: Agent for the group

T.D. 9002

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Agent for Consolidated Group

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations regarding the agent for subsidiaries of an affiliated group that files a consolidated return (agent for the group). The regulations address certain issues concerning the scope of the common parent's authority, as well as questions concerning the agent for the group when the common parent's existence terminates. These regulations affect all consolidated groups.

DATES: *Effective Date*: These regulations are effective June 28, 2002.

Applicability Date: For dates of applicability, see §§ 1.1502–77(h) and 1.1502–78(f).

FOR FURTHER INFORMATION CONTACT: Gerald B. Fleming, (202) 622–7770, or George R. Johnson, (202) 622–7930 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1699. Responses to these collections of information are required to obtain a benefit (the approval by the IRS of the common parent's designation of a substitute agent for the consolidated group or recognition by the IRS of the common parent's successor as a default substitute agent).

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

The estimated annual burden per respondent is 2 hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On September 26, 2000, a notice of proposed rulemaking (REG–103805–99, 2000–2 C.B. 376) relating to the agent for the group was published in the **Federal Register** (65 FR 57755). No public hearing was requested or held. Written comments responding to the notice of proposed rulemaking were received. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision.

Explanation and Summary of Comments

These final regulations are substantially the same as the proposed regulations but reflect certain revisions based on various formal and informal comments that were received from the public and from IRS personnel. Many of the revisions are minor changes made to clarify certain aspects of the proposed regulations. Certain of the more significant revisions are discussed below.

The final regulations reflect changes that clarify the examples of matters for which the common parent is the agent. Specifically, the example on elections is expanded to include other similar options that are available to a member in determining its separate taxable income and any changes in such options. The common parent should make any necessary requests related to those options or changes in such options (for example, to request a change in a subsidiary's method or period of accounting). In addition, an example is added to clarify that the common parent takes any action on behalf of a member of the group with respect to a foreign corporation. Finally, an example is added to clarify that a final partnership administrative adjustment (FPAA) under section 6223 may be sent to the common parent and that the mailing to the common parent will be considered a mailing to each group member that is a partner entitled to receive the FPAA.

In light of statutory changes not reflected in the proposed regulations, the final regulations modify the identification of matters reserved to subsidiaries in paragraph (a)(3) of the proposed regulations. In particular, the reference to a DISC's change in annual accounting period pursuant to § 1.991–1(b)(3)(ii) has been removed because such a change in accounting period is generally automatic and, in any event, is made by a DISC, which is not an includible corporation pursuant to section 1504(b)(7). In addition, the final regulations add as a specific matter reserved to subsidiaries any action by a subsidiary acting as the tax matters partner under the TEFRA partnership provisions of sections 6221 through 6234 and the accompanying regulations.

The provisions requiring that a notice of deficiency or notice and demand for payment name each corporation that was a member of the group for the consolidated return year have been eliminated. The IRS and Treasury have determined that these provisions are inconsistent with the general rule that the common parent is agent for the group with respect to the group's consolidated tax liability.

The final regulations have added a provision for a default substitute agent for the group under certain circumstances. If the common parent fails to designate a substitute agent before its existence terminates and it has a single successor that is a domestic corporation, that successor becomes the default substitute agent. Although the Commissioner's approval is not required, any such default substitute agent is advised to provide written notification to the IRS in accordance with procedures established by the Commissioner. Until notification is received, the Commissioner is not required to recognize the successor's status as default substitute agent and may continue to send communications to the old common parent and the Commissioner is not required to respond to communications (including, for example, a claim for refund) submitted by the successor on behalf of the consolidated group.

Where the Commissioner designates a substitute agent for the group, the proposed regulations provide for the Commissioner and the designated agent to give notice of the designation to all members of the group. The final regulations provide for the Commissioner to give notice to the designated agent, which is responsible for giving notice to the remaining members of the group.

One comment suggested that there should be a mechanism for taxpayers to request that the final regulations apply to taxable years beginning before the date of issuance of the final regulations. Treasury and the IRS recognize that some taxpayers may wish to have the additional flexibility afforded by paragraph (d)(1) of the final regulations allowing the designation

of a successor of a member (including a successor of the common parent) as the substitute agent for the group. Accordingly, the final regulations permit a common parent to elect to apply paragraph (d)(1) of the final regulations with respect to designations for taxable years beginning before the date of adoption. Once such an election is made, the provisions of paragraph (d)(1) of the final regulations apply to any subsequent designation of a substitute agent for the consolidated return years subject to the election.

Effective Date

The final regulations under § 1.1502–77 apply to taxable years beginning on or after June 28, 2002. The current rules of §§ 1.1502–77 and 1.1502–77T, which are collectively retained in § 1.1502–77A, continue to apply with respect to taxable years beginning before June 28, 2002.

The final regulations under § 1.1502–78 apply to taxable years to which a loss or credit may be carried back and for which the due date (without extensions) of the original return is after June 28, 2002.

Special Analyses

It has been determined that these final regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations will primarily affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses, and, moreover, that any burden on taxpayers is minimal. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Drafting Information

The principal authors of these proposed regulations are Gerald B. Fleming and George R. Johnson, Office of the Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing entries for "1.1502–77(e)" and "1.1502–78(b)" and adding entries in numerical order to read in part as follows:

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

Section 1.1502–77 also issued under 26 U.S.C. 1502 and 6402(j).

Section 1.1502–78 also issued under 26 U.S.C. 1502, 6402(j), and 6411(c). * * *

Section 1.1502–77A also issued under 26 U.S.C. 1502 and 6402(j). * * *

Par. 2. Section 1.338–1 is amended by adding a sentence at the end of paragraph (b)(2)(vii) to read as follows:

§ 1.338–1 General principles; status of old target and new target.

* * * * *

(b) * * *

(2) * * *

(vii) * * * See also, for example, § 1.1502–77(e)(4), providing that an election under section 338 does not result in a deemed termination of target's existence for purposes of the rules applicable to the agent for a consolidated group.

* * * * *

Par. 3. In § 1.1502–6, paragraph (b) is amended by removing the language "district director" and adding "Commissioner" in each place it appears.

Par. 4. Immediately following § 1.1502–41A, an undesignated center heading is added to read as follows:

REGULATIONS APPLICABLE TO TAXABLE YEARS BEGINNING BEFORE JUNE 28, 2002

Par. 5. Section 1.1502–77 is redesignated as § 1.1502–77A, transferred immediately after the undesignated center heading "REGULATIONS APPLICABLE TO TAXABLE YEARS BEGINNING BEFORE JUNE 28, 2002" and amended as follows:

1. The section heading is revised.

2. In the list below, for each paragraph indicated in the left column, remove the language in the middle column and add the language in the right column:

Paragraph	*Remove*	*Add*
(a), last sentence	district director	Commissioner
(b), first sentence	district director with whom the consolidated return is filed	Commissioner
(b), first sentence	such district director	the Commissioner
(b), second sentence	such district director	the Commissioner
(c)	district director	Commissioner
(d), first sentence	district director with whom the consolidated return is filed	Commissioner
(d), first sentence	such district director	the Commissioner
(d), second sentence	district director	Commissioner
(d), second sentence (each place it appears)	such district director	the Commissioner
(d), third sentence (each place it appears)	such district director	the Commissioner

3. Paragraph (e) is removed and reserved.

4. Paragraphs (f) and (g) are added.

The revision and additions read as follows:

§ 1.1502–77A Common parent agent for subsidiaries applicable for consolidated return years beginning before June 28, 2002.

* * * * *

(f) *Cross-reference*. For further rules applicable to groups that include insolvent financial institutions, see § 301. 6402–7 of this chapter.

(g) *Effective date*. This section applies to taxable years beginning before June 28, 2002, except paragraph (e) of this section applies to statutory notices and waivers of the statute of limitations for taxable years for which the due date (without extensions) of the consolidated return is after September 7, 1988, and which begin before June 28, 2002.

Par. 6. New § 1.1502–77 is added to read as follows:

§ 1.1502–77 Agent for the group.

(a) *Scope of agency*—(1) *In general*—(i) *Common parent*. Except as provided in paragraphs (a)(3) and (6) of this section, the common parent (or a substitute agent described in paragraph (a)(1)(ii) of this section) for a consolidated return year is the sole agent (agent for the group) that is authorized to act in its own name with respect to all matters relating to the tax liability for that consolidated return year, for—

(A) Each member in the group; and

(B) Any successor (see paragraph (a)(1)(iii) of this section) of a member.

(ii) *Substitute agents*. For purposes of this section, any corporation designated as a substitute agent pursuant to paragraph (d) of this section to replace the common parent or a previously designated substitute agent acts as agent for the group to the same extent and subject to the same limitations as are applicable to the common parent, and any reference in this section to the common parent includes any such substitute agent.

(iii) *Successor*. For purposes of this section only, the term *successor* means an individual or entity (including a disregarded entity) that is primarily liable, pursuant to applicable law (including, for example, by operation of a state or Federal merger statute), for the tax liability of a member of the group. Such determination is made without regard to § 1.1502–1(f)(4) or 1.1502–6(a). (For inclusion of a successor in references to a subsidiary or member, see paragraph (c)(2) of this section.)

(iv) *Disregarded entity*. If a subsidiary of a group becomes, or its successor is or becomes, a disregarded entity for Federal tax purposes, the common parent continues to serve as the agent with respect to that subsidiary's tax liability under § 1.1502–6 for consolidated return years during which it was included in the group, even though the entity generally is not treated as a person separate from its owner for Federal tax purposes.

(v) *Transferee liability*. For purposes of assessing, paying and collecting transferee liability, any exercise of or reliance on the common parent's agency authority pursuant to this section is binding on a transferee (or subsequent transferees) of a member, regardless of whether the member's existence terminates prior to such exercise or reliance.

(vi) *Purported common parent*. If any corporation files a consolidated return purporting to be the common parent of a consolidated group but is subsequently determined not to have been the common parent of the claimed group, that corporation is treated, to the extent necessary to avoid prejudice to the Commissioner, as if it were the common parent.

(2) *Examples of matters subject to agency*. With respect to any consolidated return year for which it is the common parent—

(i) The common parent makes any election (or similar choice of a permissible option) that is available to a subsidiary in the computation of its separate taxable income, and any change in an election (or similar choice of a permissible option) previously made by or for a subsidiary, including, for example, a request to change a subsidiary's method or period of accounting;

(ii) All correspondence concerning the income tax liability for the consolidated return year is carried on directly with the common parent;

(iii) The common parent files for all extensions of time, including extensions of time for payment of tax under section 6164, and any extension so filed is considered as having been filed by each member;

(iv) The common parent gives waivers, gives bonds, and executes closing agreements, offers in compromise, and all other documents, and any waiver or bond so given, or agreement, offer in compromise, or any other document so executed, is considered as having also been given or executed by each member;

(v) The common parent files claims for refund, and any refund is made directly to and in the name of the common parent and discharges any liability of the Government to any member with respect to such refund;

(vi) The common parent takes any action on behalf of a member of the group with respect to a foreign corporation, for example, elections by, and changes to the method of accounting of, a controlled foreign corporation in accordance with § 1.964–1(c)(3);

(vii) Notices of claim disallowance are mailed only to the common parent, and the mailing to the common parent is considered as a mailing to each member;

(viii) Notices of deficiencies are mailed only to the common parent (except as provided in paragraph (b) of this section), and the mailing to the common parent is considered as a mailing to each member;

(ix) Notices of final partnership administrative adjustment under section 6223 with respect to any partnership in which a member of the group is a partner may be mailed to the common parent, and, if so, the mailing to the common parent is considered as a mailing to each member that is a partner entitled to receive such notice (for other rules regarding partnership proceedings, see paragraphs (a)(3)(v) and (a)(6)(iii) of this section);

(x) The common parent files petitions and conducts proceedings before the United States Tax Court, and any such petition is considered as also having been filed by each member;

(xi) Any assessment of tax may be made in the name of the common parent, and an assessment naming the common parent is considered as an assessment with respect to each member; and

(xii) Notice and demand for payment of taxes is given only to the common parent, and such notice and demand is considered as a notice and demand to each member.

(3) *Matters reserved to subsidiaries*. Except as provided in this paragraph (a)(3) and paragraph (a)(6) of this section, no subsidiary has authority to act for or to represent itself in any matter related to the tax liability for the consolidated return year. The following matters, however, are reserved exclusively to each subsidiary—

(i) The making of the consent required by § 1.1502–75(a)(1);

(ii) Any action with respect to the subsidiary's liability for a federal tax other than the income tax imposed by chapter 1 of the Internal Revenue Code (including, for example, employment taxes under chapters 21 through 25 of the Internal Revenue Code, and miscellaneous excise taxes under chapters 31 through 47 of the Internal Revenue Code);

(iii) The making of an election under section 936(e);

(iv) The making of an election to be treated as a DISC under § 1.992–2; and

(v) Any actions by a subsidiary acting as tax matters partner under sections 6221 through 6234 and the accompanying regulations (but see paragraph (a)(2)(ix) of this section regarding the mailing of a final partnership administrative adjustment to the common parent).

(4) *Term of agency*—(i) *In general*. Except as provided in paragraph (a)(4)(iii) of this section, the common parent for the consolidated return year remains the agent for the group with respect to that year until the common parent's existence terminates, regardless of whether one or more subsidiaries in that year cease to be members of the group, whether the group files a consolidated return for any subsequent year, whether the common parent ceases to be the common parent or a member of the group in any subsequent year, or whether the group continues pursuant to § 1.1502–75(d) with a new common parent in any subsequent year.

(ii) *Replacement of substitute agent designated by Commissioner*. If the Commissioner replaces a previously designated substitute agent pursuant to paragraph (d)(3)(ii) of this section, the replaced substitute agent ceases to be the agent after the Commissioner designates another substitute agent.

(iii) *New common parent after a group structure change*. If the group continues in existence with a new common parent pursuant to § 1.1502–75(d) during a consolidated return year, the common parent at the beginning of the year is the agent for the group through the date of the § 1.1502–75(d) transaction, and the new common parent becomes the agent for the group beginning the day after the transaction, at which time it becomes the agent for the group with respect to the entire consolidated return year (including the period through the date of the transaction) and the former common parent is no longer the agent for that year.

(5) *Identifying members in notice of a lien*. Notwithstanding any other provisions of this paragraph (a), any notice of a lien, any levy or any other proceeding to collect the amount of any assessment, after the assessment has been made, must name the entity from which such collection is to be made.

(6) *Direct dealing with a member*—(i) *Several liability*. The Commissioner may, upon issuing to the common parent written notice that expressly invokes the authority of this provision, deal directly with any member of the group with respect to its liability under § 1.1502–6 for the consolidated tax of the group, in which event such member has sole authority to act for itself with respect to that liability. However, if the Commissioner believes or has reason to believe that the existence of the common parent has terminated, he may, if he deems it advisable, deal directly with any member with respect to that member's liability under § 1.1502–6 without giving the notice required by this provision.

(ii) *Information requests*. The Commissioner may, upon informing the common parent, request information relevant to the consolidated tax liability from any member of the group. However, if the Commissioner believes or has reason to believe that the existence of the common parent has terminated, he may request such information from any member of the group without informing the common parent.

(iii) *Members as partners in partnerships*. The Commissioner generally will deal directly with any member in its capacity as a partner of a partnership that is subject to the provisions of sections 6221 through 6234 and the accompanying regulations (but see paragraph (a)(2)(ix) of this section regarding the mailing of a final partnership administrative adjustment to the common parent). However, if requested to do so in accordance with the provisions of § 301.6223(c)–1(b) of this chapter, the Commissioner may deal with the common parent as agent for such member on any matter related to the partnership, except in regards to a settlement under section 6224(c) and except to the extent the member acts as tax matters partner of the partnership.

(b) *Copy of notice of deficiency to entity that has ceased to be a member of the group*. An entity that ceases to be a member of the group during or after a consolidated return year may file a written notice of that fact with the Commissioner and request a copy of any notice of deficiency with respect to the tax for a consolidated return year during which the entity was a member, or a copy of any notice and demand for payment of such deficiency, or both. Such filing does not limit the scope of the agency of the common parent provided for in paragraph (a) of this section. Any failure by the Commissioner to comply with such request does not limit an entity's tax liability under § 1.1502–6. For purposes of this paragraph (b), references to an entity include a successor of such entity.

(c) *References to member or subsidiary*. For purposes of this section, all references to a member or subsidiary for a consolidated return year include—

(1) Each corporation that was a member of the group during any part of such year (except that any reference to a subsidiary does not include the common parent);

(2) Except as indicated otherwise, a successor (as defined in paragraph (a)(1)(iii) of this section) of any corporation described in paragraph (c)(1) of this section; and

(3) Each corporation whose income was included in the consolidated return for such year, notwithstanding that the tax liability of such corporation should have been computed on the basis of a separate return, or as a member of another consolidated group, under the provisions of § 1.1502–75.

(d) *Termination of common parent*—(1) *Designation of substitute agent by common parent*. (i) If the common parent's existence terminates, it may designate a substitute agent for the group and notify the Commissioner, as provided in this paragraph (d)(1).

(A) Subject to the Commissioner's approval under paragraph (d)(1)(ii) of this section, before the common parent's existence terminates, the common parent may designate, for each consolidated return year for which it is the common parent and for which the period of limitations either for assessment, for collection after assessment, or for claiming a credit or refund has not expired, one of the following to act as substitute agent in its place—

(*1*) Any corporation that was a member of the group during any part of the consolidated return year and, except as provided in paragraph (e)(3)(ii) of this section, has not subsequently been disregarded as an entity separate from its owner or reclassified as a partnership for Federal tax purposes; or

(*2*) Any successor (as defined in paragraph (a)(1)(iii) of this section) of such a corporation or of the common parent that is a domestic corporation (and, except as provided in paragraph (e)(3)(ii) of this section, is not disregarded as an entity separate from its owner or classified as a partnership for Federal tax purposes), including a corporation that will become a successor at the time that the common parent's existence terminates.

(B) The common parent must notify the Commissioner in writing (under procedures prescribed by the Commissioner) of the designation and provide the following—

(*1*) An agreement executed by the designated corporation agreeing to serve as the group's substitute agent; and

(*2*) If the designated corporation was not itself a member of the group during the consolidated return year (because the designated corporation is a successor of a member of the group for the consolidated return year), a statement by the designated corporation acknowledging that it is or will be primarily liable for the consolidated tax as a successor of a member.

(ii) A designation under paragraph (d)(1)(i)(A) of this section does not apply unless and until it is approved by the Commissioner. The Commissioner's approval of such a designation is not effective before the existence of the common parent terminates.

(2) *Default substitute agent*. If the common parent fails to designate a substitute agent for the group before its existence terminates and if the common parent has a single successor that is a domestic corporation, such successor becomes the substitute agent for the group upon termination of the common parent's existence. However, see paragraph (d)(4) of this section regarding the consequences of the successor's failure to notify the Commissioner of its status as default substitute agent in accordance with procedures established by the Commissioner.

(3) *Designation by the Commissioner*. (i) In the event the common parent's existence terminates and no designation is made and approved under paragraph (d)(1) of this section and the Commissioner believes or has reason to believe that there is no successor of the common parent that satisfies the requirements of paragraph (d)(2) of this section (or the Commissioner believes or has reason to believe there is such a successor but has no last known address on file for such successor), the Commissioner may, at any time, with or without a request from any member of the group, designate a corporation described in paragraph (d)(1)(i)(A) of this section to act as the substitute agent. The Commissioner will notify the designated substitute agent in writing of its designation, and the designation is effective upon receipt by the designated substitute agent of such notice. The designated substitute agent must give notice of the designation to each corporation that was a member of the group during any part of the consolidated return year, but a failure by the designated substitute agent to notify any such member of the group does not invalidate the designation.

(ii) At the request of any member, the Commissioner may, but is not required to, replace a substitute agent previously designated under paragraph (d)(3)(i) of this section with another corporation described in paragraph (d)(1)(i)(A) of this section.

(4) *Absence of designation or notification of default substitute agent*. Until a designation of a substitute agent for the group under paragraph (d)(1) of this section has become effective, the Commissioner has received notification in accordance with procedures established by the Commissioner that a successor qualifying under paragraph (d)(2) of this section has become the substitute agent by default, or the Commissioner has designated a substitute agent under paragraph (d)(3) of this section—

(i) Any notice of deficiency or other communication mailed to the common parent, even if no longer in existence, is considered as having been properly mailed to the agent for the group; and

(ii) The Commissioner is not required to act on any communication (including, for example, a claim for refund) submitted on behalf of the group by any person other than the common parent (including a successor of the common parent qualifying as a default substitute agent under paragraph (d)(2) of this section).

(e) *Termination of a corporation's existence*—(1) *In general*. For purposes of paragraphs (a)(1)(v), (a)(4)(i), and (d) of this section, the existence of a corporation is deemed to terminate if—

(i) Its existence terminates under applicable law; or

(ii) Except as provided in paragraph (e)(3) of this section, it becomes, for Federal tax purposes, either—

(A) An entity that is disregarded as an entity separate from its owner; or

(B) An entity that is reclassified as a partnership.

(2) *Purported agency*. If the existence of the agent for the group terminates under circumstances described in paragraph (e)(1)(ii) of this section, until the Commissioner has approved the designation of a substitute agent for the group pursuant to paragraph (d)(1) of this section or the Commissioner designates a substitute agent and notifies the designated substitute agent pursuant to paragraph (d)(3) of this section, any post-termination action by that purported agent on behalf of the group has the same effect, to the extent necessary to avoid prejudice to the Commissioner, as if the agent's corporate existence had not terminated.

(3) *Exceptions where no eligible corporation exists*. (i) For purposes of the common parent's term as agent under paragraph (a)(4)(i) of this section and the

term as agent of the substitute agent designated under paragraph (d) of this section, if a corporation either becomes disregarded as an entity separate from its owner or is reclassified as a partnership for Federal tax purposes, its existence is not deemed to terminate if the effect of such termination would be that no corporation remains eligible to serve as the substitute agent for the group's consolidated return year.

(ii) Similarly, for purposes of paragraph (d) of this section, an entity that is either disregarded as an entity separate from its owner or reclassified as a partnership for Federal tax purposes is not precluded from designation as a substitute agent merely because of such classification if the effect of the inability to make such designation would be that no corporation remains eligible to serve as the substitute agent for the group's consolidated return year.

(iii) Any entity described in paragraphs (e)(3)(i) or (ii) of this section that remains or becomes the agent for the group is treated as a corporation for purposes of this section.

(4) *Exception for section 338 transactions*. Notwithstanding section 338(a)(2), a target corporation for which an election is made under section 338 is not deemed to terminate for purposes of this section.

(f) *Examples*. The following examples illustrate the principles of this section. Unless otherwise indicated, each example addresses the question of which corporation is the proper party to execute a consent to waive the statute of limitations for Years 1 and 2 or the more general question of which corporation may be designated as a substitute agent for the group for Years 1 and 2. In each example, as of January 1 of Year 1, the P group consists of P and its two subsidiaries, S and S–1. P, as the common parent of the P group, files consolidated returns for the P group in Years 1 and 2. On January 1 of Year 1, domestic corporations S–2, U, V, W, W–1, X, Y, Z and Z–1 are not related to P or the members of the P group. All corporations are calendar year taxpayers. For none of the tax years at issue does the Commissioner exercise the authority under paragraph (a)(6) of this section to deal with any member separately. Any surviving corporation in a merger is a successor as described in paragraph (a)(1)(iii) of this section. Any notification to the Commissioner of the designation of the P group's substitute agent also contains a statement signed on behalf of the designated agent that it agrees to act as the group's substitute agent and, in the case of a successor, that it is primarily liable as a successor of a member. The examples are as follows:

Example 1. Disposition of all group members. On December 31 of Year 1, P sells all the stock of S–1 to X. On December 31 of Year 2, P distributes all the stock of S to P's shareholders. P files a separate return for Year 3. Although P is no longer a common parent after Year 2, P remains the agent for the P group for Years 1 and 2. For as long as P remains in existence, only P may execute a waiver of the period of limitations on assessment on behalf of the group for Years 1 and 2.

Example 2. Acquisition of common parent by another group. The facts are the same as in *Example 1*, except on January 1 of Year 3, all of the outstanding stock of P is acquired by Y. P thereafter joins in the Y group consolidated return as a member of Y group. Although P is a member of Y group in Year 3, P remains the agent for the P group for Years 1 and 2. For as long as P remains in existence, only P may execute a waiver of the period of limitations on assessment on behalf of the P group for Years 1 and 2.

Example 3. Merger of common parent—designation of remaining member as substitute agent. On December 31 of Year 1, P sells all the stock of S–1 to X. On July 1 of Year 2, P acquires all the stock of S–2. On November 30 of Year 2, P distributes all the stock of S to P's shareholders. On January 1 of Year 3, P merges into Y corporation. Just before the merger, P notifies the Commissioner in writing of the planned merger and of its designation of S as the substitute agent for the P group for Years 1 and 2. S is the only member that P can designate as the substitute agent for both Years 1 and 2 because it is the only subsidiary that was a member of the P group during part of both years. Although S–2 is the only remaining subsidiary of the P group when P merges into Y, S–2 was a member of the P group only in Year 2. For that reason, S–2 cannot be the substitute agent for the P group for Year 1. Alternatively, P could designate a different substitute agent for each year, selecting S or S–1 as the substitute agent for Year 1, and S or S–2 as the substitute agent for Year 2. P could also designate its successor Y as the substitute agent for both Years 1 and 2.

Example 4. Forward triangular merger of common parent. On January 1 of Year 3, P merges with and into Z–1, a subsidiary of Z, in a forward triangular merger described in section 368(a)(1)(A) and (a)(2)(D). The transaction constitutes a reverse acquisition under § 1.1502–75(d)(3)(i) because P's shareholders receive more than 50% of Z's stock in exchange for all of P's stock. Just before the merger, P notifies the Commissioner in writing of the planned merger and its designation of Z–1, the corporation that will survive the planned merger, as the substitute agent of the P group for Years 1 and 2. Because Z–1 will be P's successor (within the meaning of paragraph (a)(1) of this section) after the planned merger, P may designate Z–1 as the substitute agent for the P group for Years 1 and 2, pursuant to paragraph (d)(1) of this section. Alternatively, P could have designated S or S–1 as the substitute agent for the P group for Years 1 and 2. Although Z is the new common parent of the P group, which continues pursuant to § 1.1502–75(d)(3)(i), P may not designate Z as the substitute agent for Years 1 and 2 because Z was not a member of the group during any part of Years 1 or 2 and is not a successor of P or any other member of P group.

Example 5. Reverse triangular merger of common parent. On March 1 of Year 3, W–1, a subsidiary of W, merges into P, in a reverse triangular merger described in section 368(a)(1)(A) and (a)(2)(E). P survives the merger with W–1. The transaction constitutes a reverse acquisition under § 1.1502–75(d)(3)(i) because P's shareholders receive more than 50% of W's stock in exchange for all of P's stock. Under paragraph (a) of this section, P remains the agent for the P group for Years 1 and 2, even though the P group continues with W as its new common parent pursuant to § 1.1502–75(d)(3)(i). Because the transaction constitutes a reverse acquisition, the P group is treated as remaining in existence with W as its common parent. Before March 2 of Year 3, P is the agent for the P group for Year 3. Beginning on March 2 of Year 3, W becomes the agent for the P group with respect to all of Year 3 (including the period through March 1) and subsequent consolidated return years. For as long as P remains in existence, P remains the agent of the P group under paragraph (a) of this section for Years 1 and 2, and therefore only P may execute a waiver of the period of limitations on assessment on behalf of the P group for Years 1 and 2.

Example 6. Reverse triangular merger of common parent—subsequent spinoff of common parent. The facts are the same as in *Example 5*, except that on April 1 of Year 4, in a transaction unrelated to the Year 3 reverse acquisition, P distributes the stock of its subsidiaries S and S–1 to W, and W then distributes the stock of P to the W shareholders. Beginning on March 2 of Year 3, W becomes the agent for the P group with respect to Year 3 (including the period through March 1) and subsequent consolidated return years. Although P is no longer a member of the P group after the Year 4 spinoff, P remains the agent for the P group under paragraph (a) of this section for Years 1 and 2. Thus, for as long as P remains in existence, only P may execute a waiver of the period of limitations on assessment on behalf of the P group for Years 1 and 2.

Example 7. Qualified stock purchase and section 338 election. On March 31 of Year 2, V purchases the stock of P in a qualified stock purchase (within the meaning of section 338(d)(3)), and V makes a timely election pursuant to section 338(g) with respect to P. Although section 338(a)(2) provides that P is treated as a new corporation as of the beginning of the day after the acquisition date for purposes of subtitle A, paragraph (e)(4) of this section provides that P's existence is not deemed to terminate for purposes of this section notwithstanding the general rule of section 338(a)(2). Therefore, the election under section 338(g) does not result in a termination of P under paragraph (e) of this section, and new P remains the agent of the P group for Year 1 and the period ending March 31 of Year 2 (short Year 2). For as long as new P remains in existence, only new P may execute a waiver of the period of

limitations on assessment on behalf of the P group for Year 1 and short Year 2.

Example 8. Fraudulent conveyance of assets. On March 15 of Year 2, P files a consolidated return that includes the income of S and S–1 for Year 1. On December 1 of Year 2, S–1 transfers assets having a fair market value of $100x to U in exchange for $10x. This transfer of assets for less than fair market value constitutes a fraudulent conveyance under applicable state law. On March 1 of Year 5, P executes a waiver extending to December 31 of Year 6 the period of limitations on assessment with respect to the group's Year 1 consolidated return. On February 1 of Year 6, the Commissioner issues a notice of deficiency to P asserting a deficiency of $30x for the P group's Year 1 consolidated tax liability. P does not file a petition for redetermination in the Tax Court, and the Commissioner makes a timely assessment against the P group. P, S and S–1 are all insolvent and are unable to pay the deficiency. On February 1 of Year 8, the Commissioner sends a notice of transferee liability to U, which does not file a petition in the Tax Court. On August 1 of Year 8, the Commissioner assesses the amount of the P group's deficiency against U. Under section 6901(c), the Commissioner may assess U's transferee liability within one year after the expiration of the period of limitations against the transferor S–1. By operation of section 6213(a) and 6503(a), the issuance of the notice of deficiency to P and the expiration of the 90-day period for filing a petition in the Tax Court have the effect of further extending by 150 days the P group's limitations period on assessment from the previously extended date of December 31 of Year 6 to May 30 of Year 7. Pursuant to paragraph (a)(1)(v) of this section, the waiver executed by P on March 1 of Year 5 to extend the period of limitations on assessment to December 31 of Year 6 and the further extension of the P group's limitations period to May 30 of Year 7 (by operation of sections 6213(a) and 6503(a)) have the derivative effect of extending the period of limitations on assessment of U's transferee liability to May 30 of Year 8. By operation of section 6901(f), the issuance of the notice of transferee liability to U and the expiration of the 90-day period for filing a petition in the Tax Court have the effect of further extending the limitations period on assessment of U's liability as a transferee by 150 days, from May 30 of Year 8 to October 27 of Year 8. Accordingly, the Commissioner may send a notice of transferee liability to U at any time on or before May 30 of Year 8 and assess the unpaid liability against U at any time on or before October 27 of Year 8. The result would be the same even if S–1 ceased to exist before March 1 of Year 5, the date P executed the waiver.

(g) *Cross-reference*. For further rules applicable to groups that include insolvent financial institutions, see § 301.6402–7 of this chapter.

(h) *Effective date*—(1) *Application*—(i) *In general*. This section applies with respect to taxable years beginning on or after June 28, 2002.

(ii) *Election to apply for prior taxable years*. Notwithstanding paragraphs (h)(1)(i) and (h)(2) of this section, the common parent may elect to apply paragraph (d)(1) of this section in lieu of § 1.1502–77A(d) in designating a substitute agent for taxable years beginning before June 28, 2002. The common parent makes such an election by expressly referring to the election under this paragraph (h)(1)(ii) in notifying the Commissioner of the designation of the substitute agent. Once made, such election applies to any subsequent designation of a substitute agent for the consolidated return year(s) subject to the election.

(2) *Prior law*. For taxable years beginning before June 28, 2002, see § 1.1502–77A.

§ 1.1502–77T(a) [Redesignated as § 1.1502–77A(e) and Amended]

Par. 7. Section 1.1502–77T(a) is redesignated as § 1.1502–77A(e) and is amended by removing the language "district director" and adding "Commissioner" in each place it appears.

§ 1.1502–77T [Removed]

Par. 8. Section 1.1502–77T is removed.

Par. 9. Section 1.1502–78 is amended as follows:

1. Paragraph (a) is revised.

2. Paragraph (b)(1) is amended by adding the language "for the carryback year (or agent designated under § 1.1502–77(d) for the carryback year)" at the end of the first sentence.

3. Paragraph (b)(2) is amended by removing the language "6213(b)(2)" and adding "6213(b)(3)" in its place.

4. In paragraph (c), the last sentence of *Example (1)* is amended by adding the language "for the carryback year" after "parent."

5. In paragraph (c), the last sentence of *Example (2)* is amended by removing the language "S–1" and adding "P" in its place.

6. In paragraph (c) *Example (3)*, the seventh sentence is amended by removing the language "Z must" and adding "X must" in its place.

7. In paragraph (c) *Example (3)*, the last sentence is amended by removing the language "6213(b)(2)" and adding "6213(b)(3)" in its place.

8. Paragraph (e)(2)(v) is removed.

9. Paragraph (f) is added.

The revision and addition read as follows:

§ 1.1502–78 Tentative carryback adjustments.

(a) *General rule*. If a group has a consolidated net operating loss, a consolidated net capital loss, or a consolidated unused business credit for any taxable year, then any application under section 6411 for a tentative carryback adjustment of the taxes for a consolidated return year or years preceding such year shall be made by the common parent corporation for the carryback year (or substitute agent designated under § 1.1502–77(d) for the carryback year) to the extent such loss or unused business credit is not apportioned to a corporation for a separate return year pursuant to § 1.1502–21(b), 1.1502–22(b), or 1.1502–79(c). In the case of the portion of a consolidated net operating loss or consolidated net capital loss or consolidated unused business credit to which the preceding sentence does not apply and that is to be carried back to a corporation that was not a member of a consolidated group in the carryback year, the corporation to which such loss or credit is attributable shall make any application under section 6411. In the case of a net capital loss or net operating loss or unused business credit arising in a separate return year that may be carried back to a consolidated return year, after taking into account the application of § 1.1502–21(b)(3)(ii)(B) with respect to any net operating loss arising in another consolidated group, the common parent for the carryback year (or substitute agent designated under § 1.1502–77(d) for the carryback year) shall make any application under section 6411.

* * * * *

(f) *Effective date*—(1) *In general*. This section applies to taxable years to which a loss or credit may be carried back and for which the due date (without extensions) of the original return is after June 28, 2002, except that the provisions of paragraph (e)(2) apply for applications by new members of consolidated groups for tentative carryback adjustments resulting from net operating losses, net capital losses, or unused business credits arising

in separate return years of new members that begin on or after January 1, 2001.

(2) *Prior law*. For taxable years to which a loss or credit may be carried back and for which the due date (without extensions) of the original return is on or before June 28, 2002, see § 1.1502–78 in effect prior to June 28, 2002, as contained in 26 CFR part 1 revised April 1, 2002.

Par. 10. Immediately before § 1.1502–79A, an undesignated center heading is added to read as follows:

REGULATIONS APPLICABLE TO TAXABLE YEARS BEFORE JANUARY 1, 1997

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 11. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 12. Section 602.101, paragraph (b) is amended by adding an entry in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.1502–77	1545–1699
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved May 20, 2002.

Pamela F. Olson,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 27, 2002, 8:45 a.m., and published in the issue of the Federal Register for June 28, 2002, 67 F.R. 43538)

Section 4972.—Tax on Nondeductible Contributions to Qualified Employer Plans

Whether "restorative payments" to a qualified defined contribution plan are contributions. See Rev. Rul. 2002–45, page 116.

Section 6045.—Returns of Brokers

26 CFR 1.6045–1(c)(3)(ii): Excepted sales.

Information Reporting on Form 1099–B. Exception from reporting on Form 1099–B in connection with certain stock option transactions, under specified conditions. See Rev. Proc. 2002–50, page 173.

Section 6103.—Confidentiality and Disclosure of Returns and Return Information

26 CFR 301.6103(j)(5)–1: Disclosures of return information to officers and employees of the Department of Agriculture for certain statistical purposes and related activities.

T.D. 9001

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

Disclosure of Return Information to Officers and Employees of the Department of Agriculture for Certain Statistical Purposes and Related Activities

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This contains a final regulation relating to return information to be disclosed to the Department of Agriculture (Department) for use in conducting the Census of Agriculture. The regulation provides for the disclosure of an additional item of return information to the Department. The regulation provides guidance to IRS personnel responsible for disclosing the return information.

DATES: *Effective Date*: This final regulation is effective June 19, 2002.

Applicability Date: For dates of applicability of this final regulation, see § 301.6103(j)(5)–1(d).

FOR FURTHER INFORMATION CONTACT: Joseph Conley, 202–622–4580 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Under section 6103(j)(5) of the Internal Revenue Code (Code), upon written request from the Secretary of Agriculture, the Secretary of the Treasury shall furnish such returns or return information as prescribed by Treasury regulation to officers and employees of the Department whose official duties require access to such returns or return information for the purpose of, but only to the extent necessary in, structuring, preparing, and conducting the Census of Agriculture pursuant to the Census of Agriculture Act of 1997. Currently, § 301.6103(j)(5)–1 provides an itemized description of the return information authorized to be disclosed for this purpose. By letter dated May 8, 2001, the Secretary of Agriculture requested that the Treasury Regulations be amended to authorize the disclosure of an additional item of return information, the taxpayer's

telephone number contained on Form 1040/Schedule F.

This document adopts a final regulation that authorizes IRS personnel to disclose the additional item of return information that has been requested by the Secretary of Agriculture.

Explanation of Provisions

This final regulation will permit the IRS to disclose to the Department, for its use in structuring, preparing, and conducting the Census of Agriculture, an additional item of return information, the taxpayer's telephone number provided on the Form 1040/Schedule F. According to the Department, the disclosure of this additional item of return information will improve the efficiency of the Department's list-building operations by reducing the potential for duplication in the Census of Agriculture. After receiving information from the IRS, the Department attempts to link such information to other records held by or available to the Department, doing so where possible on the basis of names, social security numbers or employer identification numbers, and addresses. The Department intends to use taxpayer telephone numbers to match records that cannot be matched otherwise or to determine that questionable links between records, such as those based merely on name and address information, constitute or do not constitute definite matches. By means of the matching process, the Department avoids duplicate contacts and furthers its classification of farms for Census of Agriculture purposes. The IRS will provide taxpayer telephone numbers to the Department under this final regulation with the understanding that the Department will only use them for such purpose, and that it will not use the information to telephone taxpayers.

Special Analyses

Section 553 of the Administrative Procedure Act (5 U.S.C. chapter 5) requires that a notice of proposed rulemaking be published in the Federal Register and, after such notice, that the Federal agency that issued the notice give interested persons an opportunity to participate in the rulemaking through submission of written comments, with or without opportunity for oral presentation. These requirements are subject to certain exceptions, including when the agency for good cause finds that notice and public comment are impracticable, unnecessary, or contrary to the public interest. Because the final regulation merely amends a preexisting regulation (§ 301.6103(j)(5)–1) to add a single item of information to a list of such items, it is determined that the notice and public-comment procedure required by 5 U.S.C. 553 is unnecessary in this case pursuant to the exception in 5 U.S.C. 553(b)(3)(B). For the same reason, a delayed effective date is not required pursuant to 5 U.S.C. 553(d)(3)

It has also been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Because no notice of proposed rulemaking is required, the provisions of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) do not apply. Pursuant to section 7805(f) of the Code, this regulation was submitted to the Chief Counsel of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of this temporary regulation is Joseph Conley, Office of Associate Chief Counsel (Procedure & Administration), Disclosure and Privacy Law Division.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301 — PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding an entry in numerical order to read in part as follows:

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

Section 301.6103(j)(5)–1 also issued under 26 U.S.C. 6103(j)(5); * * *

Par. 2. Section 301.6103(j)(5)–1 is amended by adding paragraph (b)(2)(xiv) to read as follows:

§ 301.6103(j)(5)–1 Disclosures of return information to officers and employees of the Department of Agriculture for certain statistical purposes and related activities.

* * * * *

(b) * * *

(2) * * *

(xiv) Taxpayer telephone number.

* * * * *

(d) *Effective dates*. This section is applicable on July 31, 2001, except paragraph (b)(2)(xiv) which is applicable on June 19, 2002.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved June 10, 2002.

Pamela F. Olson,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 18, 2002, 8:45 a.m., and published in the issue of the Federal Register for June 19, 2002, 67 F.R. 41621)

Part III. Administrative, Procedural, and Miscellaneous

Deduction for Contributions of an Employer to an Employees' Trust or Annuity Plan and Compensation Under a Deferred-Payment Plan

Notice 2002–48

Questions have arisen about certain variations on the fact pattern described in Rev. Rul. 90–105, 1990–2 C.B. 69, and their effect on the timing of an employer's deduction for contributions to a cash or deferred arrangement within the meaning of § 401(k) or to a defined contribution plan as matching contributions within the meaning of § 401(m). Rev. Rul. 2002–46, page 118 of this Bulletin, addresses a fact pattern that is substantially similar to the fact pattern in Rev. Rul. 90–105. This notice addresses two other variations on this fact pattern. The facts in Rev. Rul. 90–105 involve contributions that are attributable to compensation earned after the end of an employer's taxable year and are made after the end of that year but during the § 404(a)(6) grace period. Rev. Rul. 90–105 holds that such contributions are not deductible for the taxable year.

In Rev. Rul. 2002–46, the plan is amended to provide for a board resolution setting a minimum contribution for a plan year (to be allocated first toward elective deferrals and matching contributions, with any excess to be allocated to participants as of the end of the plan year in proportion to compensation earned during the plan year), and a board resolution is adopted before the end of the taxable year pursuant to that amendment. Rev. Rul. 2002–46 reaches the same result as Rev. Rul. 90–105.

This notice addresses two other variations on the Rev. Rul. 90–105 fact pattern, neither of which involves grace period contributions. One variation involves an actual payment to the plan before the end of the taxable year, in anticipation of § 401(k) deferrals and § 401(m) matches to occur after the end of the tax year (but before the end of the overlapping plan year). The other variation involves such a prepayment, combined with a guaranteed minimum contribution as described in Rev. Rul. 2002–46. Because these variations involve actual payments before the end of the taxable year, § 404(a)(6) and Rev. Rul. 90–105, 1990–2 C.B. 69, do not affect the deductibility of the contributions.

Rev. Rul. 90–105 based its holding in part upon § 1.404(a)–1(b) of the Income Tax Regulations. Specifically, Rev. Rul. 90–105 relied upon language in the regulation requiring that contributions be compensation for services actually rendered. Upon further consideration, the Service has concluded that this language is relevant only where the reasonableness of an employee's compensation is in question, and thus is not an appropriate basis upon which to determine the timing of deductions for the contributions described in Rev. Rul. 90–105, Rev. Rul. 2002–46, and this notice.

The Service is reviewing other issues that may be raised by the two factual patterns addressed in this notice. Any additional guidance concerning the matters addressed in this notice will be prospective in application. Pending such additional guidance, the Service will not challenge the deductibility of contributions described in this notice, provided actual payment is made during the taxable year and the amount deducted does not exceed the applicable limitation under § 404(a)(3)(A)(i).

The transactions described in this notice are not "reportable transactions" for purposes of § 1.6011–4T(b)(1) of the Temporary Income Tax Regulations and are not "listed transactions" for purposes of § 301.6111–2T(b)(2) of the Temporary Procedure and Administration Regulations.

The principal author of this notice is John Richards of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, contact Mr. Richards at (202) 622–6090 (not a toll-free call).

Weighted Average Interest Rate Update

Notice 2002–49

Sections 412(b)(5)(B) and 412(l)(7)(C)(i) of the Internal Revenue Code provide that the interest rates used to calculate current liability for purposes of determining the full funding limitation under § 412(c)(7) and the required contribution under § 412(l) must be within a permissible range around the weighted average of the rates of interest on 30-year Treasury securities during the four-year period ending on the last day before the beginning of the plan year.

Notice 88–73, 1988–2 C.B. 383, provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Code.

Section 417(e)(3)(A)(ii)(II) of the Code defines the applicable interest rate, which must be used for purposes of determining the minimum present value of a participant's benefit under § 417(e)(1) and (2), as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. Section 1.417(e)–1(d)(3) of the Income Tax Regulations provides that the applicable interest rate for a month is the annual interest rate on 30-year Treasury securities as specified by the Commissioner for that month in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin.

The rate of interest on 30-year Treasury Securities for June 2002 is 5.52 percent. Pursuant to Notice 2002–26, 2002–15 I.R.B. 743, the Service has determined this rate as the monthly average of the daily determination of yield on the 30-year Treasury bond maturing in February 2031.

Section 405 of the Job Creation and Worker Assistance Act of 2002 amended § 412(l)(7)(C) of the Code to provide that

for plan years beginning in 2002 and 2003 the permissible range is extended to 120 percent.

The following rates were determined for the plan years beginning in the month shown below.

Month	Year	Weighted Average	90% to 110% Permissible Range	90% to 120% Permissible Range
July	2002	5.67	5.10 to 6.23	5.10 to 6.80

Drafting Information

The principal author of this notice is Todd Newman of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone service at 1–877–829–5500 (a toll-free number), between the hours of 8:00 a.m. and 6:30 p.m. Eastern time, Monday through Friday. Mr. Newman may be reached at 1–202–283–9888 (not a toll-free number).

Bonds for Solid Waste Disposal Facilities

Notice 2002–51

PURPOSE

The Treasury Department and the Internal Revenue Service have received inquiries regarding the application of section 142(a)(6) of the Internal Revenue Code to recycling facilities. As part of the Priority Guidance Plan for the period July 1, 2002 through June 30, 2003, Treasury and the IRS intend to undertake a guidance project to address the application of section 142(a)(6) to recycling facilities. Accordingly, Treasury and the IRS are soliciting public comment on the issue.

BACKGROUND

Generally, interest on a state or local bond is excluded from gross income under section 103. However, section 103(b) provides that the exclusion does not apply to a private activity bond unless the bond is a qualified bond. Section 141(e) defines "qualified bond" to include an exempt facility bond that meets certain requirements. Section 142(a) lists the categories of exempt facility bonds, which include bonds for solid waste disposal facilities under section 142(a)(6).

Section 142(a)(6) was added to the Code as part of the Tax Reform Act of 1986, P.L. 99–514; 100 Stat. 2606; 1986–3 C.B. (Vol. 1) 523. However, exempt activity financing for solid waste disposal facilities was not first introduced in the 1986 Act. Rather, it was also permitted under section 103(b)(4)(E) of the Internal Revenue Code of 1954. Guidance has been issued under section 103(b)(4)(E) that is applicable to section 142(a)(6). The Conference Report to the 1986 Act provides that "[t]he conference agreement allows exempt-facility bonds to be issued to finance solid waste disposal facilities, defined generally as under present law." Conf. Rpt. 99–841 (Vol. II), at II–704; 1986–3 C.B. (Vol. 4) 704.

Section 1.103–8(f)(2)(ii)(a) of the regulations defines "solid waste disposal facilities" as any property or portion thereof used for the collection, storage, treatment, utilization, processing, or final disposal of solid waste. Section 1.103–8(f)(2)(ii)(b) provides that the term "solid waste" has the same meaning as in former section 203(4) of the Solid Waste Disposal Act (42 U.S.C. § 3252(4)), as quoted in the regulations, except that material will not qualify as solid waste unless, on the date of issue of the obligations issued to provide the facility to dispose of the waste material, it is property that is useless, unused, unwanted, or discarded solid material which has no market or other value at the place where it is located. Thus, where any person is willing to purchase the property, at any price, the material is not waste. However, if any person is willing to remove the property at his own expense but is not willing to purchase it at any price, the material is waste.

Former section 203(4) of the Solid Waste Disposal Act, as quoted in § 1.103–8(f)(2)(ii)(b), provides that,

> The term "solid waste" means garbage, refuse, and other discarded solid materials, including solid-waste materials resulting from industrial, commercial, and agricultural operations, and from community activities, but does not include solids or dissolved material in domestic sewage or other significant pollutants in water resources, such as silt, dissolved or suspended solids in industrial waste water effluents, dissolved materials in irrigation return flows or other common water pollutants.

Section 1.103–8(f)(2)(ii)(c) states that a facility that disposes of solid waste by reconstituting, converting, or otherwise recycling it into material that is not waste shall also qualify as a solid waste disposal facility if solid waste constitutes at least 65 percent, by weight or volume, of the total materials introduced into the recycling process. Such a recycling facility shall not fail to qualify as a solid waste disposal facility solely because it operates at a profit.

Section 17.1(a) of the Temporary regulations provides that, in the case of property that has both a solid waste disposal function and a function other than the disposal of solid waste, only the portion of the cost of the property allocable to the function of solid waste disposal is taken into account as an expenditure to provide solid waste disposal facilities. However, a facility that otherwise qualifies as a solid waste disposal facility will not be treated as having a function other than solid

waste disposal merely because material or heat which has utility or value is recovered or results from the disposal process. Where materials or heat are recovered, the waste disposal function includes the processing of those materials or heat that occurs in order to put them into the form in which the materials or heat are in fact sold or used, but does not include further processing which converts the materials or heat into other products.

Section 17.1(c) of the Temporary regulations contains an example in which Company A proposed to build a recycling facility that would process discarded waste by separating out metals, glass, and similar materials. As separated, some of the items were commercially saleable. However, A did not intend to sell the metals and glass until the metals were further separated, sorted, sized and cleaned and the glass was pulverized. The metals and pulverized glass would then be sold to commercial users. The example concludes that the waste disposal function includes such processing of the metals and glass, but does not include further processing.

The example further provides that the remaining waste was burned and the heat produced was used to make steam. Company B, which operated an adjacent generating facility, could use steam for power. B needed steam with certain characteristics and as a result, certain of A's equipment was more costly than it would have been to produce steam for some other uses. The example concludes that the disposal function includes the equipment actually used to put the heat into the form in which it was sold. If A constructed pipes to carry the steam to B's facility, the pipes would not be included in the solid waste disposal function. Similarly, if A installed generating equipment and used the steam to generate electricity, the disposal function would not include the generating equipment.

In Revenue Ruling 72–190, 1972–1 C.B. 29, bonds financed facilities leased to a private corporation. The facilities reconstituted discarded solid materials from a manufacturing process so that the materials could be reintroduced into a manufacturing process. The corporation had previously discarded the materials resulting from its manufacturing process because they could not be reintroduced into its production process or sold for use by someone else. Thus, at the time the facilities were constructed, the discarded materials were of no value to the corporation at the place where they were discarded. The ruling concludes that the facilities are solid waste disposal facilities.

In Revenue Ruling 75–184, 1975–1 C.B. 41, bonds financed facilities leased to a private person, P, that used the facilities to recycle used corrugated containers into corrugated paperboard. To provide the raw material needed for the operations, P entered into a ten-year contract with an unrelated corporation, M. M collected and sorted discarded corrugated containers from the refuse stream to meet its obligations under the contract with P, which included baling and loading for transportation. The price P paid to M consisted of a specified amount per ton for processing plus an additional specified amount per ton for the containers, F.O.B., at M's location. The ruling concludes that the containers were not solid waste because they had value at M's location and P was willing to purchase them at a stated price.

In Revenue Ruling 76–222, 1976–1 C.B. 26, bonds financed facilities leased to a private person, X, that used the facilities for collecting and processing garbage into fuel for subsequent sale to Y, a public utility. X received the garbage from garbage collectors at collection stations. X did not pay for the garbage; rather, it received a fee from the garbage collectors for the privilege of dumping their garbage. The garbage was then packed into containers for transportation by truck or train to X's processing station adjacent to Y's utility plant. At the processing station, the garbage was reduced to a small, uniform size and classified into noncombustible and combustible fractions. Noncombustible fractions were sold to scrap dealers or placed in a landfill. The combustible fraction was fed to a surge bin from which it was blown into boilers at Y's utility plant. Y paid X a stipulated amount per ton for the combustible fractions based on their BTU value. The ruling concludes that the facilities, other than the equipment used to transport the fuel from the surge bin to the boilers, are solid waste disposal facilities.

In Revenue Ruling 80–197, 1980–2 C.B. 44, bonds financed facilities acquired by the taxpayer, a private beverage manufacturer. The taxpayer used the facilities to package beverages in reusable containers. State law prohibited the sale of beverages in non-returnable containers and required beverage purchasers to pay a deposit that was refunded on return of the beverage containers. The taxpayer determined that it was less costly to use reusable containers than it was to use new containers. The ruling notes that if a reusable container is not returned, but is discarded, it could potentially become solid waste. However, once the reusable container is returned to the taxpayer and the deposit is refunded to the retailer, the reusable container is not useless, unwanted, or discarded solid material. The ruling concludes that even though a market for used containers did not exist by virtue of the mandatory deposit, reusable containers had value to the taxpayer because reuse of these containers was less costly than the purchase of new containers, and thus the containers were not solid waste.

REQUEST FOR PUBLIC COMMENTS

Treasury and the IRS are soliciting public comments regarding the application of section 142(a)(6) to recycling facilities. Treasury and the IRS also invite comments on any other issues concerning the application of that Code provision.

Taxpayers may submit comments in writing to:

Internal Revenue Service
Attn: CC:CORP:R
(Notice 2002–51,
Room 5226)
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Alternatively, taxpayers may submit comments electronically at: *http://www.irs.ustreas.gov/prod/cover.html* (the IRS Internet Site)

All comments should be received by October 21, 2002. The comments submitted will be available for public inspection and copying.

DRAFTING INFORMATION

The principal authors of this notice are Michael Brewer and Rebecca Harrigal of the Office of the Assistant Chief Counsel (CC:TEGE:EOEG). For further information regarding this notice, contact Mr. Brewer at (202) 622–3980 (not a toll-free call).

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26 CFR 601.202: Closing agreements.

Rev. Proc. 2002–47

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PART I. INTRODUCTION TO EMPLOYEE PLANS COMPLIANCE RESOLUTION SYSTEM

SECTION 1. PURPOSE AND OVERVIEW

.01 *Purpose*. This revenue procedure updates the comprehensive system of correction programs for sponsors of retirement plans that are intended to satisfy the requirements of § 401(a), § 403(a), § 403(b), or § 408(k) of the Internal Revenue Code (the "Code"), but that have not met these requirements for a period of time. This system, the Employee Plans Compliance Resolution System ("EPCRS"), permits plan sponsors to correct these failures and thereby continue to provide their employees with retirement benefits on a tax-favored basis. The components of EPCRS are the Self-Correction Program ("SCP"), the Voluntary Correction Program ("VCP"), and the Audit Closing Agreement Program ("Audit CAP").

.02 *General principles underlying EPCRS*. EPCRS is based on the following general principles:

- Sponsors and other administrators of eligible plans should be encouraged to establish administrative practices and procedures that ensure that these plans are operated properly in accordance with the applicable requirements of the Code.
- Sponsors and other administrators of eligible plans should satisfy the applicable plan document requirements of the Code.
- Plan sponsors and other administrators should make voluntary and timely correction of any plan failures, whether involving discrimination in favor of highly compensated employees, plan operations, the terms of the plan document, or adoption of a plan by an ineligible employer. Timely and efficient correction protects participating employees by providing them with their expected retirement benefits, including favorable tax treatment.
- Voluntary compliance is promoted by providing for limited fees for voluntary corrections approved by the Service, thereby reducing employers' uncertainty regarding their potential tax liability and participants' potential tax liability.
- Fees and sanctions should be graduated in a series of steps so that there is always an incentive to correct promptly.
- Sanctions for plan failures identified on audit should be reasonable in light of the nature, extent, and severity of the violation.
- Administration of EPCRS should be consistent and uniform.
- Plan Sponsors should be able to rely on the availability of EPCRS in taking corrective actions to maintain the tax-favored status of their plans.

.03 *Overview*. EPCRS includes the following basic elements:

- *Self-correction (SCP)*. A plan sponsor that has established compliance practices and procedures may, at any time, correct insignificant Operational Failures without paying any fee or sanction. In addition, in the case of a Qualified Plan that is the subject of a favorable determination letter from the Service or in the case of a 403(b) Plan, the plan sponsor generally may correct even significant Operational Failures without payment of any fee or sanction.
- *Voluntary correction with Service approval (VCP)*. A plan sponsor, at any time before audit, may pay a limited fee and receive the Service's approval for correction. Under VCP, there are special procedures for certain submissions involving only Operational Failures (Voluntary Correction of Operational Failures ("VCO")), and for certain submissions in which limited Operational Failures are being corrected using standardized corrections (Voluntary Correction of Operational Failures Standardized ("VCS")). VCP also includes a special procedure that applies to 403(b) Plans (Voluntary Correction of Tax-sheltered Annuity Failures ("VCT")), a special procedure for anonymous submissions ("Anonymous Submission Procedure"), a special procedure for group submissions (Voluntary Correction of Group Failures ("VCGroup")), and a special procedure that applies to SEPs (Voluntary Correction of SEP Failures ("VCSEPs")).
- *Correction on audit (Audit CAP)*. If a failure (other than a failure corrected through SCP or VCP) is identified on audit, the plan sponsor may correct the failure and pay a sanction. The sanction imposed will bear a reasonable relationship to the nature, extent and severity of the failure, taking into account the extent to which correction occurred before audit.

SECTION 2. EFFECT OF THIS REVENUE PROCEDURE ON PROGRAMS

.01 *Effect on programs*. This revenue procedure modifies and supersedes Rev. Proc. 2001–17, 2001–1 C.B. 589, which was the prior consolidated statement of the correction programs under EPCRS. The modifications to Rev. Proc. 2001–17 that are reflected in this revenue procedure include:

- extending the duration of the self-correction period under SCP for significant operational compliance failures where the Plan Sponsor assumes a plan in connection with a corporate merger, acquisition, or other transaction. (section 9.02(2))
- extending the Anonymous Submission Procedure indefinitely. (section 10.13(3))
- expanding the Anonymous Submission Procedure to permit the submission of failures listed in Appendix A and Appendix B. (section 10.13(1))
- expanding the Anonymous Submission Procedure to VCGroup and VCSEP submissions. (section 10.13(1))
- expanding the definition of Employer Eligibility Failure to include the adoption of a 401(k) plan by any ineligible employer. (section 5.01(2)(d))
- broadening the VCGroup procedures to permit eligible organizations to submit operational and plan document failures in a single submission. (section 10.15(1))
- increasing the *de minimis* amount relating to corrective distributions. (section 6.02(5)(b))
- providing a *de minimis* rule for correcting certain Overpayments. (section 6.02(5)(c))
- clarifying the date by which correction of a failure related to Transferred Assets must be completed. (section 12.08)
- clarifying that the correction of failures in a terminated plan may be made under VCP. (section 10.03)
- clarifying what items may be excluded from the initial submission under the Anonymous Submission Procedure. (section 10.13(1))
- updating the definition of Favorable Letter. (section 5.01(4))
- modifying the correction procedure relating to Excess Amounts under VCT and overcontributions under VCSEP. (sections 12.05(3) and 12.07(2))
- clarifying the factors considered under Audit CAP for determining a sanction amount. (section 14.02)
- revising the checklist in Appendix C to include questions relating to Transferred Assets and the waiver of the excise tax under § 4974. (Appendix C items 10 and 18)

In addition, the following sections have been modified for purposes of clarification: sections 4.05, 5.01(8), 5.02(3), 6.02(3), 6.02(5)(d), 6.05(1), 6.05(2)(a) and (b), 9.05 Example 1, 10.06, 10.09, 10.13(2), 10.15(2), 10.15(3)(b), 11.01, 11.02(11), 11.03(4), 11.04(3), 11.04(4), 11.05, 11.12, 12.01(1), 12.01(3)(a), 12.02, 12.08, 13.02, 14.03, 15, 16, 17, Appendix A .05, Appendix B 2.01(b)(i) and 2.07(3), and Appendix C checklist item 26.

.02 *Future enhancements*. (1) It is expected that the EPCRS revenue procedure will continue to be updated on a periodic basis, including, as noted above, further improvements to EPCRS based on comments previously received. In addition, the Service and Treasury continue to invite further comments on how to improve EPCRS. Comments should be sent to:

Internal Revenue Service
Attention: T:EP:RA:VC
1111 Constitution Avenue, NW
Washington, D.C. 20224

(2) The Service and Treasury are considering expanding the procedures under EPCRS and are interested in receiving comments regarding, among other things, appropriate correction procedures for failures arising under SIMPLE IRAs (under § 408(p)) and § 457(b) plans. Submissions related to SIMPLE IRAs are currently being accepted by the Service on a provisional basis outside of EPCRS. Submissions relating to § 457(b) eligible governmental plans will be accepted by the Service on a provisional basis outside of EPCRS. Submissions relating to other § 457(b) eligible plans may be accepted outside EPCRS as Employee Plans develops experience in the § 457 area.

PART II. PROGRAM EFFECT AND ELIGIBILITY

SECTION 3. EFFECT OF EPCRS; RELIANCE

.01 *Effect of EPCRS on Qualified Plans*. For a Qualified Plan, if the eligibility requirements of section 4 are satisfied and the Plan Sponsor corrects a Qualification Failure in accordance with the applicable requirements of SCP in section 7, VCP in sections 10 and 11, or Audit CAP in section 13, the Service will not treat the Qualified Plan as failing to meet § 401(a). Thus, for example, if the Plan Sponsor corrects the failures in accordance with the requirements of this revenue procedure, the plan will be treated as a qualified plan for purposes of applying § 3121(a)(5) (FICA taxes) and § 3306(b)(5) (FUTA taxes).

.02 *Effect of EPCRS on 403(b) Plans*. (1) *Income taxes*. For a 403(b) Plan, if the applicable eligibility requirements of section 4 are satisfied and the Plan Sponsor corrects a failure in accordance with the applicable requirements of SCP in section 7, VCP in sections 10 and 11, or Audit CAP in section 13, the Service will not pursue income inclusion for affected participants, or liability for income tax withholding, on account of the failure. However, the correction of a failure may result in income tax consequences to participants and beneficiaries (for example, participants may be required to include in gross income distributions of Excess Amounts in the year of distribution).

(2) *Excise and employment taxes*. Excise taxes, FICA taxes, and FUTA taxes (and corresponding withholding obligations), if applicable, that result from a failure are not waived merely because the failure has been corrected.

.03 *Effect of EPCRS on SEPs*. For a SEP, if the eligibility requirements of section 4 are satisfied and the Plan Sponsor corrects a failure to satisfy the requirements of § 408(k) in accordance with the applicable requirements of SCP in section 7 (but only if the corresponding Qualification Failure is an insignificant Operational Failure), VCP in sections 10 and 11, or Audit CAP in section 13, the Service will not treat the SEP as failing to

meet § 408(k). Thus, for example, if the Plan Sponsor corrects the failures in accordance with the requirements of this revenue procedure, the SEP will be treated as satisfying § 408(k) for purposes of applying § 3121(a)(5) (FICA taxes) and § 3306(b)(5) (FUTA taxes).

.04 *Compliance Statement*. If a Plan Sponsor or Eligible Organization receives a compliance statement under VCP, the compliance statement is binding upon the Service and the Plan Sponsor or Eligible Organization as provided in section 10.08.

.05 *Other taxes and penalties*. See section 6.07 for rules relating to other taxes and penalties.

.06 *Reliance*. Taxpayers may rely on this revenue procedure, including the relief described in sections 3.01, 3.02, and 3.03.

SECTION 4. PROGRAM ELIGIBILITY

.01 *Programs for Qualified Plans and 403(b) Plans*. (1) *SCP*. Qualified Plans and 403(b) Plans are eligible for SCP. SCP is available only for Operational Failures.

(2) *VCP*. Qualified Plans and 403(b) Plans are eligible for VCP. VCP provides general procedures for correction of all Qualification Failures: Operational, Plan Document, Demographic, and Employer Eligibility.

(3) *Audit CAP*. Audit CAP is available for correction of all failures found on examination that have not been corrected in accordance with SCP or VCP.

.02 *Eligibility for other arrangements*. (1) A SEP that is maintained under a Plan Document is eligible for SCP with respect to insignificant failures and is eligible for VCP (under the special VCSEP procedure). A SEP is also eligible for Audit CAP. For purposes of EPCRS, a failure to satisfy § 408(k) is treated like the corresponding Qualification Failure. A failure to satisfy § 408(k) includes a failure to satisfy the 50%-eligible-employees election requirement of § 408(k)(6)(A)(ii) and a failure to satisfy the 25-employee limit of § 408(k)(6)(B).

(2) The Service may extend EPCRS to other arrangements.

.03 *Effect of examination*. If the plan or Plan Sponsor is Under Examination, VCP is not available. However, while the plan or Plan Sponsor is Under Examination, insignificant Operational Failures can be corrected under SCP and, if correction has been substantially completed before the plan or Plan Sponsor is Under Examination, significant Operational Failures can be corrected under SCP.

.04 *Favorable Letter requirement*. VCO and the provisions of SCP relating to significant Operational Failures (see section 9) are available for a Qualified Plan only if the plan is the subject of a Favorable Letter.

.05 *Established practices and procedures*. In order to be eligible for SCP, the Plan Sponsor or administrator of a plan must have established practices and procedures (formal or informal) reasonably designed to promote and facilitate overall compliance with applicable Code requirements. For example, the plan administrator of a Qualified Plan that may be top-heavy under § 416 may include in its plan operating manual a specific annual step to determine whether the plan is top-heavy and, if so, to ensure that the minimum contribution requirements of the top-heavy rules are satisfied. A plan document alone does not constitute evidence of established procedures. In order for a Plan Sponsor or administrator to use SCP, these established procedures must have been in place and routinely followed, and an Operational Failure must have occurred through an oversight or mistake in applying them or because of an inadequacy in the procedures. In the case of a failure that relates to Transferred Assets or to a plan assumed in connection with a corporate merger, acquisition, or other similar employer transaction between the Plan Sponsor and sponsor of the transferor plan or the prior plan sponsor of an assumed plan, the plan is considered to have established practices and procedures if such practices and procedures are in effect by the end of the first plan year that begins after the corporate merger, acquisition, or other similar transaction.

.06 *Correction by plan amendment*. (1) *Availability of correction by plan amendment in VCP general procedures*. A Plan Sponsor may use VCP for a Qualified Plan to correct an Operational Failure by a plan amendment to conform the terms of the plan to the plan's prior operations, provided that the amendment complies with the requirements of § 401(a), including the requirements of §§ 401(a)(4), 410(b), and 411(d)(6).

(2) *Certain correction by plan amendment permitted in SCP and VCO*. A Plan Sponsor may use SCP or VCO for a Qualified Plan to correct an Operational Failure by a plan amendment to conform the terms of the plan to the plan's prior operations only to correct Operational Failures listed in section 2.07 of Appendix B. These failures must be corrected in accordance with the correction methods set forth in section 2.07 of Appendix B. The amendment must comply with the requirements of § 401(a), including the requirements of §§ 401(a)(4), 410(b), and 411(d)(6). SCP and VCO are not otherwise available for a Plan Sponsor to correct an Operational Failure by a plan amendment. Thus, if loans were made to participants, but the plan document did not permit loans to be made to participants, the failure cannot be corrected under SCP or VCO by retroactively amending the plan to provide for the loans. However, if a Plan Sponsor corrects an Operational Failure in accordance with SCP or VCO, it may amend the plan to the extent necessary to reflect the corrective action. For example, if the plan failed to satisfy the average deferral percentage ("ADP") test required under § 401(k)(3) and the Plan Sponsor must make qualified nonelective contributions not already provided for under the plan, the plan may be amended to provide for qualified nonelective contributions. The issuance of a compliance statement does not constitute a determination as to the effect of any plan amendment on the qualification of the plan.

.07 *Submission for a determination letter*. In a case in which correction of a Qualification Failure includes correction of a Plan Document Failure or correction of an Operational Failure by plan amendment, as permitted under section 4.06, other than adoption of an amendment designated by the Service as a model amendment or standardized prototype plan, the amendment must be submitted to the Service for approval using the appropriate application form (*i.e.*, the Form 5300 series or, if permitted, Form 6406) to ensure that the amendment satisfies applicable qualification requirements.

.08 *Availability of correction of Employer Eligibility Failure*. A Plan

Sponsor may use VCP general procedures, VCT, or VCSEP to correct an Employer Eligibility Failure. However, under sections 4.01, 4.02, and 10, SCP, VCO, and VCGroup are not available for a Plan Sponsor to correct an Employer Eligibility Failure.

.09 *Egregious failures*. SCP, VCO, VCGroup, and VCSEP are not available to correct Operational Failures that are egregious. For example, if an employer has consistently and improperly covered only highly compensated employees or if a contribution to a defined contribution plan for a highly compensated individual is several times greater than the dollar limit set forth in § 415, the failure would be considered egregious. VCP is available to correct egregious failures; however, these failures are subject to the fees described in sections 12.01(4) and 12.05(6).

.10 *Diversion or misuse of plan assets*. SCP, VCP, and Audit CAP are not available to correct failures relating to the diversion or misuse of plan assets.

PART III. DEFINITIONS, CORRECTION PRINCIPLES, AND RULES OF GENERAL APPLICABILITY

SECTION 5. DEFINITIONS

The following definitions apply for purposes of this revenue procedure:

.01 *Definitions for Qualified Plans*. The definitions in this section 5.01 apply to Qualified Plans.

(1) *Qualified Plan*. The term "Qualified Plan" means a plan intended to satisfy the requirements of § 401(a) or § 403(a).

(2) *Qualification Failure*. The term "Qualification Failure" means any failure that adversely affects the qualification of a plan. There are four types of Qualification Failures: (a) Plan Document Failures, (b) Operational Failures, (c) Demographic Failures, and (d) Employer Eligibility Failures.

(a) *Plan Document Failure*. The term "Plan Document Failure" means a plan provision (or the absence of a plan provision) that, on its face, violates the requirements of § 401(a) or § 403(a). Thus, for example, the failure of a plan to be amended to reflect a new qualification requirement within the plan's applicable remedial amendment period under § 401(b) is a Plan Document Failure. For purposes of this revenue procedure, a Plan Document Failure includes any Qualification Failure that is a violation of the requirements of § 401(a) or § 403(a) and that is not an Operational Failure, Demographic Failure, or Employer Eligibility Failure.

(b) *Operational Failure*. The term "Operational Failure" means a Qualification Failure (other than an Employer Eligibility Failure) that arises solely from the failure to follow plan provisions. A failure to follow the terms of the plan providing for the satisfaction of the requirements of § 401(k) and § 401(m) is considered to be an Operational Failure. A plan does not have an Operational Failure to the extent the plan is permitted to be amended retroactively pursuant to § 401(b) or another statutory provision to reflect the plan's operations. However, if within an applicable remedial amendment period under § 401(b), a plan has been properly amended for statutory or regulatory changes and, on or after the later of the date the amendment is effective or is adopted, the amended provisions are not followed, then the plan is considered to have an Operational Failure.

(c) *Demographic Failure*. The term "Demographic Failure" means a failure to satisfy the requirements of § 401(a)(4), § 401(a)(26), or § 410(b) that is not an Operational Failure or an Employer Eligibility Failure. The correction of a Demographic Failure generally requires a corrective amendment to the plan adding more benefits or increasing existing benefits (cf., § 1.401(a)(4)–11(g)).

(d) *Employer Eligibility Failure*. The term "Employer Eligibility Failure" means the adoption of a plan intended to satisfy the requirements of § 401(a) or § 408(k) by an employer that fails to meet the employer eligibility requirements to establish a § 401(k) or § 408(k) plan. An Employer Eligibility Failure is not a Plan Document, Operational, or Demographic Failure.

(3) *Excess Amount*. The term "Excess Amount" means (a) an Overpayment, (b) an elective deferral or employee after-tax contribution returned to satisfy § 415, (c) an elective deferral in excess of the limitation of § 402(g) that is distributed, (d) an excess contribution or excess aggregate contribution that is distributed to satisfy § 401(k) or § 401(m), (e) an amount contributed on behalf of an employee that is in excess of the employee's benefit provided under a SEP, (f) an excess contribution that is distributed to satisfy § 408(k)(6)(A)(iii), (g) an elective deferral that is distributed to satisfy the limitation of § 401(a)(17), or (h) any similar amount that is required to be distributed in order to maintain plan qualification.

(4) *Favorable Letter*. The term "Favorable Letter" means, in the case of a Qualified Plan, a current favorable determination letter for an individually designed plan (including a volume submitter plan that is not identical to an approved volume submitter plan), a current favorable opinion letter for a Plan Sponsor that has adopted a master or prototype plan, (standardized or nonstandardized), or a current favorable advisory letter and certification that the Plan Sponsor has adopted a plan that is identical to an approved volume submitter plan. A plan has a current favorable determination letter, opinion letter, or advisory letter if (a), (b), (c), (d), (e), (f), (g), or (h) below is satisfied:

(a) The plan has a favorable determination letter, opinion letter, or advisory letter/certification that considers GUST (GUST is an acronym for the Uruguay Round Agreements Act (GATT), the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA), the Small Business Job Protection Act of 1996 (SBJPA), the Taxpayer Relief Act of 1997 (TRA '97), the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA '98), and the Community Renewal Tax Relief Act of 2000 (CRA).)

(b) The plan (i) either has a favorable determination letter, opinion letter, or notification letter for a regional prototype plan that considers the Tax Reform Act of 1986 ("TRA '86") or was initially adopted or effective after December 7, 1994, and, (ii) the Plan Sponsor has by the later of February 28, 2002, or the last day of the first plan year beginning on or after January 1, 2001, either submitted an application for a determination letter on GUST, or has adopted or certified that it intends to adopt a master and prototype

plan (includes former regional prototype plans) or volume submitter plan, that has been submitted for a GUST opinion letter or advisory letter by December 31, 2000.

(c) The plan has a favorable determination letter that considers the Tax Reform Act of 1986 ("TRA '86") or was initially adopted or effective after December 7, 1994, and the plan is a plan directly affected by the September 11, 2001, terrorist attack on the United States, (see Rev. Proc. 2001–55, 2001–49 I.R.B. 552) and the Plan Sponsor has by June 30, 2002, submitted an application for a determination letter request for GUST.

(d) The plan was timely amended for TRA '86, the Unemployment Compensation Act of 1992 ("UCA"), and the Omnibus Budget and Reconciliation Act of 1993 ("OBRA '93") and the Plan Sponsor has submitted an application for a determination letter on GUST by September 3, 2002, in accordance with the procedures set forth in Rev. Proc. 2002–35, 2002–24 I.R.B. 1187.

(e) The plan is initially adopted or effective after February 28, 2002, and the Plan Sponsor timely submits an application for a determination letter within the plan's remedial amendment period under § 401(b).

(f) The plan is a governmental plan or non-electing church plan described in Rev. Proc. 99–23, 1999–1 C.B. 920, and has a favorable determination, opinion, or notification letter that considers the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), the Deficit Reduction Act of 1984 ("DEFRA"), and the Retirement Equity Act of 1984 ("REA"), and the § 401(b) remedial amendment period for TRA '86 has not yet expired.

(g) The plan is terminated prior to the expiration of the applicable GUST remedial amendment period under § 401(b) and the plan was amended to reflect the provisions of GUST.

(h) In the case of a SEP, the term "Favorable Letter" means (i) a valid Model Form 5305–SEP or 5305A-SEP adopted by an employer in accordance with the instructions on the applicable Form, (ii) a current favorable opinion letter for a Plan Sponsor that has adopted a prototype SEP which has been amended in accordance with procedures set forth in Rev. Proc. 94–13, 1994–1 C.B. 566, to take into account any applicable changes in the law since the issuance of the opinion letter, or (iii) in the case of an individually designed SEP, a private letter ruling that has been issued for the SEP.

(5) *Maximum Payment Amount*. The term "Maximum Payment Amount" means a monetary amount that is approximately equal to the tax the Service could collect upon plan disqualification and is the sum for the open taxable years of the:

(a) tax on the trust (Form 1041),

(b) additional income tax resulting from the loss of employer deductions for plan contributions (and any interest or penalties applicable to the Plan Sponsor's return), and

(c) additional income tax resulting from income inclusion for participants in the plan (Form 1040).

(6) *Overpayment*. The term "Overpayment" means a distribution to an employee or beneficiary that exceeds the employee's or beneficiary's benefit under the terms of the plan because of a failure to comply with plan terms that implement § 401(a)(17), § 401(m) (but only with respect to the forfeiture of nonvested matching contributions that are excess aggregate contributions), § 411(a)(3)(G), or § 415. An Overpayment does not include a distribution of any Excess Amount described in section 5.01(3)(b) through (h).

(7) *Plan Sponsor*. The term "Plan Sponsor" means the employer that establishes or maintains a qualified retirement plan for its employees.

(8) *Transferred Assets*. The term "Transferred Assets" means plan assets that were received, in connection with a corporate merger, acquisition or other similar employer transaction, by the plan in a transfer (including a merger or consolidation of plan assets) under § 414(l) from a plan sponsored by an employer that was not a member of the same controlled group as the Plan Sponsor prior to the corporate merger, acquisition, or other similar employer transaction. If a transfer of plan assets related to the same employer transaction is accomplished through several transfers, then the date of the transfer is the date of the first transfer.

.02 *Definitions for 403(b) Plans*. The definitions in this section 5.02 apply to 403(b) Plans.

(1) *403(b) Plan*. The term "403(b) Plan" means a plan or program intended to satisfy the requirements of § 403(b).

(2) *403(b) Failure*. A 403(b) Failure is any Operational, Demographic, or Employer Eligibility Failure as defined below.

(a) *Operational Failure*. The term "Operational Failure" means any of the following:

(i) A failure to satisfy the requirements of § 403(b)(12)(A)(ii) (relating to the availability of salary reduction contributions);

(ii) A failure to satisfy the requirements of § 401(m) (as applied to 403(b) Plans pursuant to § 403(b)(12)(A)(i));

(iii) A failure to satisfy the requirements of § 401(a)(17) (as applied to 403(b) Plans pursuant to § 403(b)(12)(A)(i));

(iv) A failure to satisfy the distribution restrictions of § 403(b)(7) or § 403(b)(11);

(v) A failure to satisfy the incidental death benefit rules of § 403(b)(10);

(vi) A failure to pay minimum required distributions under § 403(b)(10);

(vii) A failure to give employees the right to elect a direct rollover under § 403(b)(10), including the failure to give meaningful notice of such right;

(viii) A failure of the annuity contract or custodial agreement to provide participants with a right to elect a direct rollover under §§ 403(b)(10) and 401(a)(31);

(ix) A failure to satisfy the limit on elective deferrals under § 403(b)(1)(E);

(x) A failure of the annuity contract or custodial agreement to provide the limit on elective deferrals under §§ 403(b)(1)(E) and 401(a)(30);

(xi) A failure involving contributions or allocations of Excess Amounts; or

(xii) Any other failure to satisfy applicable requirements under § 403(b) that (A) results in the loss of § 403(b) status for the plan or the loss of § 403(b) status for one or more custodial account(s) or annuity contract(s) under the plan and (B) is not a Demographic Failure, an Employer Eligibility Failure, or a failure related to the purchase of

annuity contracts, or contributions to custodial accounts, on behalf of individuals who are not employees of the employer.

(b) *Demographic Failure*. The term "Demographic Failure" means a failure to satisfy the requirements of § 401(a)(4), § 401(a)(26), or § 410(b) (as applied to 403(b) Plans pursuant to § 403(b)(12)(A)(i)).

(c) *Employer Eligibility Failure*. The term "Employer Eligibility Failure" means any of the following:

(i) The adoption of a plan intended to satisfy the requirements of § 403(b) by an employer that is not a tax-exempt organization described in § 501(c)(3) or a public educational organization described in § 170(b)(1)(A)(ii);

(ii) A failure to satisfy the nontransferability requirement of § 401(g);

(iii) A failure to initially establish or maintain a custodial account as required by § 403(b)(7); or

(iv) A failure to purchase (initially or subsequently) either an annuity contract from an insurance company (unless grandfathered under Rev. Rul. 82–102, 1982–1 C.B. 62) or a custodial account from a regulated investment company utilizing a bank or an approved non-bank trustee/custodian.

(3) *Excess Amount*. The term "Excess Amount" means any contributions or allocations that are in excess of the limits under § 415 for the year (and for years prior to 1/1/02, the § 403(b)(2) exclusion allowance limit for the year).

(4) *Plan Sponsor*. The term "Plan Sponsor" means the employer that offers a 403(b) Plan to its employees.

(5) *Total Sanction Amount*. The term "Total Sanction Amount" means a monetary amount that is approximately equal to the income tax the Service could collect as a result of the failure.

.03 *Under Examination*. (1) The term "Under Examination" means: (a) a plan that is under an Employee Plans examination (that is, an examination of a Form 5500 series or other Employee Plans examination), or (b) a Plan Sponsor that is under an Exempt Organizations examination (that is, an examination of a Form 990 series or other Exempt Organizations examination).

(2) A plan that is under an Employee Plans examination includes any plan for which the Plan Sponsor, or a representative, has received verbal or written notification from Employee Plans of an impending Employee Plans examination, or of an impending referral for an Employee Plans examination, and also includes any plan that has been under an Employee Plans examination and is now in Appeals or in litigation for issues raised in an Employee Plans examination. A plan is considered to be Under Examination if it is aggregated for purposes of satisfying the nondiscrimination requirements of § 401(a)(4), the minimum participation requirements of § 401(a)(26), the minimum coverage requirements of § 410(b), or the requirements of § 403(b)(12), with a plan(s) that is Under Examination. In addition, a plan is considered to be Under Examination with respect to a failure of a qualification requirement (other than those described in the preceding sentence) if the plan is aggregated with another plan for purposes of satisfying that qualification requirement (for example, § 402(g), § 415, or § 416) and that other plan is Under Examination. For example, assume Plan A has a § 415 failure, Plan A is aggregated with Plan B only for purposes of § 415, and Plan B is Under Examination. In this case, Plan A is considered to be Under Examination with respect to the § 415 failure. However, if Plan A has a failure relating to the spousal consent rules under § 417 or the vesting rules of § 411, Plan A is not considered to be Under Examination with respect to the § 417 or § 411 failure. For purposes of this revenue procedure, the term aggregation does not include consideration of benefits provided by various plans for purposes of the average benefits test set forth in § 410(b)(2).

(3) An Employee Plans examination also includes a case in which a Plan Sponsor has submitted a Form 5310 and the Employee Plans agent notifies the Plan Sponsor, or a representative, of possible Qualification Failures, whether or not the Plan Sponsor is officially notified of an "examination." This would include a case where, for example, a Plan Sponsor has applied for a determination letter on plan termination, and an Employee Plans agent notifies the Plan Sponsor that there are partial termination concerns.

(4) A Plan Sponsor that is under an Exempt Organizations examination includes any Plan Sponsor that has received (or whose representative has received) verbal or written notification from Exempt Organizations of an impending Exempt Organizations examination or of an impending referral for an Exempt Organizations examination and also includes any Plan Sponsor that has been under an Exempt Organizations examination and is now in Appeals or in litigation for issues raised in an Exempt Organizations examination.

.04 *SEP*. The term "SEP" means a plan intended to satisfy the requirements of § 408(k). For purposes of this revenue procedure, the term SEP also includes a salary reduction SEP ("SARSEP") described in § 408(k)(6), when applicable.

SECTION 6. CORRECTION PRINCIPLES AND RULES OF GENERAL APPLICABILITY

.01 *Correction principles; rules of general applicability*. The general correction principles in section 6.02 and rules of general applicability in sections 6.03 through 6.10 apply for purposes of this revenue procedure.

.02 *Correction principles*. Generally, a failure is not corrected unless full correction is made with respect to all participants and beneficiaries, and for all taxable years (whether or not the taxable year is closed). Even if correction is made for a closed taxable year, the tax liability associated with that year will not be redetermined because of the correction. In the case of a Qualified Plan with an Operational Failure, correction is determined taking into account the terms of the plan at the time of the failure. Correction should be accomplished taking into account the following principles:

(1) *Restoration of benefits*. The correction method should restore the plan to the position it would have been in had the failure not occurred, including restoration of current and former participants and beneficiaries to the benefits and rights they would have had if the failure had not occurred.

(2) *Reasonable and appropriate correction*. The correction should be reasonable and appropriate for the failure. Depending on the nature of the failure, there may be more than one reasonable and appropriate correction for the failure.

For Qualified Plans, any correction method permitted under Appendix A or Appendix B is deemed to be a reasonable and appropriate method of correcting the related Qualification Failure. Any correction method permitted under Appendix A applicable to a 403(b) Plan is deemed to be a reasonable and appropriate method of correcting the related 403(b) Failure. Whether any other particular correction method is reasonable and appropriate is determined taking into account the applicable facts and circumstances and the following principles:

(a) The correction method should, to the extent possible, resemble one already provided for in the Code, regulations thereunder, or other guidance of general applicability. For example, for Qualified Plans, the defined contribution plan correction methods set forth in § 1.415–6(b)(6) would be the typical means of correcting a failure under § 415. Likewise, the correction method set forth in § 1.402(g)–1(e)(2) would be the typical means of correcting a failure under § 402(g).

(b) The correction method for failures relating to nondiscrimination should provide benefits for nonhighly compensated employees. For example, for Qualified Plans, the correction method set forth in § 1.401(a)(4)–11(g) (rather than methods making use of the special testing provisions set forth in § 1.401(a)(4)–8 or § 1.401(a)(4)–9) would be the typical means of correcting a failure to satisfy nondiscrimination requirements. Similarly, the correction of a failure to satisfy the requirements of § 401(k)(3), § 401(m)(2), or § 401(m)(9) (relating to nondiscrimination), solely by distributing excess amounts to highly compensated employees would not be the typical means of correcting such a failure.

(c) The correction method should keep plan assets in the plan, except to the extent the Code, regulations, or other guidance of general applicability provide for correction by distribution to participants or beneficiaries or return of assets to the employer or Plan Sponsor. For example, if an excess allocation (not in excess of the § 415 limits) made under a Qualified Plan was made for a participant under a plan (other than a cash or deferred arrangement), the excess should be reallocated to other participants or, depending on the facts and circumstances, used to reduce future employer contributions.

(d) The correction method should not violate another applicable specific requirement of § 401(a) or § 403(b) (for example, § 401(a)(4), § 411(d)(6), or § 403(b)(12), as applicable), or § 408(k) for SEPs. If an additional failure is created as a result of the use of a correction method in this revenue procedure, then that failure also must be corrected in conjunction with the use of that correction method and in accordance with the requirements of this revenue procedure.

(3) *Consistency Requirement*. Generally, where more than one correction method is available to correct a type of Operational Failure for a plan year (or where there are alternative ways to apply a correction method), the correction method (or one of the alternative ways to apply the correction method) should be applied consistently in correcting all Operational Failures of that type for that plan year. Similarly, earnings adjustment methods generally should be applied consistently with respect to corrective contributions or allocations for a particular type of Operational Failure for a plan year. In the case of a VCGroup submission, the consistency requirement applies on a plan by plan basis.

(4) *Principles regarding corrective allocations and corrective distributions*. The following principles apply where an appropriate correction method includes the use of corrective allocations or corrective distributions:

(a) Corrective allocations under a defined contribution plan should be based upon the terms of the plan and other applicable information at the time of the failure (including the compensation that would have been used under the plan for the period with respect to which a corrective allocation is being made) and should be adjusted for earnings (including losses) and forfeitures that would have been allocated to the participant's account if the failure had not occurred. The corrective allocation need not be adjusted for losses. See section 3 of Appendix B for additional information on calculation of earnings for corrective allocations.

(b) A corrective allocation to a participant's account because of a failure to make a required allocation in a prior limitation year will not be considered an annual addition with respect to the participant for the limitation year in which the correction is made, but will be considered an annual addition for the limitation year to which the corrective allocation relates. However, the normal rules of § 404, regarding deductions, apply.

(c) Corrective allocations should come only from employer contributions (including forfeitures if the plan permits their use to reduce employer contributions).

(d) In the case of a defined benefit plan, a corrective distribution for an individual should be increased to take into account the delayed payment, consistent with the plan's actuarial adjustments.

(5) *Special exceptions to full correction*. In general, a failure must be fully corrected. Although the mere fact that correction is inconvenient or burdensome is not enough to relieve a Plan Sponsor of the need to make full correction, full correction may not be required in certain situations because it is unreasonable or not feasible. Even in these situations, the correction method adopted must be one that does not have significant adverse effects on participants and beneficiaries or the plan, and that does not discriminate significantly in favor of highly compensated employees. The exceptions described below specify those situations in which full correction is not required.

(a) *Reasonable estimates*. If it is not possible to make a precise calculation, or the probable difference between the approximate and the precise restoration of a participant's benefits is insignificant and the administrative cost of determining precise restoration would significantly exceed the probable difference, reasonable estimates may be used in calculating appropriate correction.

(b) *Delivery of small benefits*. If the total corrective distribution due a participant or beneficiary is $50 or less, the Plan Sponsor is not required to make the corrective distribution if the reasonable direct costs of processing and delivering the distribution to the participant or beneficiary would exceed the amount of the distribution.

(c) *Recovery of small Overpayments*. Generally, for a submission under VCP, if the total amount of an Overpayment made to a participant or beneficiary

is $100 or less, the Plan Sponsor is not required to seek the return of the Overpayment from the participant or beneficiary.

(d) *Locating lost participants*. Reasonable actions must be taken to find all current and former participants and beneficiaries to whom additional benefits are due, but who have not been located after a mailing to the last known address. In general, such actions include use of the Internal Revenue Service Letter Forwarding Program (see Rev. Proc. 94–22, 1994–1 C.B. 608) or the Social Security Administration Employer Reporting Service. A plan will not be considered to have failed to correct a failure due to the inability to locate an individual if either of these programs is used; provided that, if the individual is later located, the additional benefits must be provided to the individual at that time.

(6) *Reporting*. Any distributions from the plan should be properly reported.

.03 *Correction of an Employer Eligibility Failure (only available under VCP general procedures, VCT, and VCSEP).* (1) The permitted correction of an Employer Eligibility Failure is the cessation of all contributions (including salary reduction and after-tax contributions) beginning no later than the date the application under VCP is filed. Pursuant to VCP correction, the assets in such a plan are to remain in the trust, annuity contract, or custodial account and are to be distributed no earlier than the occurrence of one of the applicable distribution events, *e.g.*, for 403(b) Plans, the events described in § 403(b)(7) (to the extent the assets are held in custodial accounts) or § 403(b)(11) (for those assets invested in annuity contracts that would be subject to § 403(b)(11) restrictions if the employer were eligible). A Plan that is corrected through VCP will be treated as subject to all of the requirements and provisions of § 401(a) for a Qualified Plan, § 403(b) for a 403(b) Plan, and § 408(k) for a SEP (including Code provisions relating to rollovers).

(2) Cessation of contributions is not required if continuation of contributions would not be an Employer Eligibility Failure (for example, a tax-exempt employer may maintain a § 401(k) plan after 1996).

(3) Because a plan with an Employer Eligibility Failure will be treated as subject to all of the applicable Code qualification requirements, the Plan Sponsor must also correct all other failures in accordance with this revenue procedure.

.04 *Correction by plan amendment.* In any case in which correction of a Qualified Plan failure includes correction of a Plan Document Failure or correction of an Operational Failure by plan amendment as permitted under section 4.06, other than adoption of a model amendment or a standardized prototype plan, the amendment must be submitted to the Service for approval under the appropriate application form (*i.e.*, Form 5300 series or Form 6406) to ensure that the amendment satisfies applicable qualification requirements.

.05 *Special rules relating to Excess Amounts*. (1) *Treatment of Excess Amounts under Qualified Plans.* A distribution of an Excess Amount is not eligible for the favorable tax treatment accorded to distributions from Qualified Plans (such as eligibility for rollover under § 402(c)). To the extent that a current or prior distribution was a distribution of an Excess Amount, distribution of that Excess Amount is not an eligible rollover distribution. Thus, for example, if such a distribution was contributed to an individual retirement arrangement ("IRA"), the contribution is not a valid rollover contribution for purposes of determining the amount of excess contributions (within the meaning of § 4973) to the individual's IRA. A distribution of an Excess Amount is generally treated in the manner described in section 3 of Rev. Proc. 92–93, 1992–2 C.B. 505, relating to the corrective disbursement of elective deferrals. The distribution must be reported on Forms 1099–R for the year of distribution with respect to each participant or beneficiary receiving such a distribution. Where an Excess Amount has been or is being distributed, the Plan Sponsor must notify the recipient that (a) an Excess Amount has been or will be distributed and (b) an Excess Amount is not eligible for favorable tax treatment accorded to distributions from Qualified Plans (and, specifically, is not eligible for tax-free rollover).

(2) *Treatment of Excess Amounts under 403(b) Plans*. (a) *Distribution of Excess Amounts*. Excess Amounts for a year, adjusted for earnings through the date of distribution, must be distributed to affected participants and beneficiaries and are includible in their gross income in the year of distribution. The distribution of Excess Amounts is not an eligible rollover distribution within the meaning of § 403(b)(8). A distribution of Excess Amounts is generally treated in the manner described in section 3 of Rev. Proc. 92–93 relating to the corrective disbursement of elective deferrals. The distribution must be reported on Forms 1099–R for the year of distribution with respect to each participant or beneficiary receiving such a distribution. In addition, the Plan Sponsor must inform affected participants and beneficiaries that the distribution of Excess Amounts is not eligible for rollover.

(b) *Retention of Excess Amounts*. Under VCT and Audit CAP, Excess Amounts will be treated as corrected (even though the Excess Amounts are retained in the 403(b) Plan) if the following requirements are satisfied. Excess Amounts arising from a § 415 failure, adjusted for earnings through the date of correction, must reduce affected participants' applicable § 415 limit for the year following the year of correction (or for the year of correction if the Plan Sponsor so chooses), and subsequent years, until the excess is eliminated.

.06 *Correction under statute or regulations*. Generally, none of the correction programs are available to correct failures that can be corrected under the Code and related regulations. For example, as a general rule, a Plan Document Failure that is a disqualifying provision for which the remedial amendment period under § 401(b) has not expired can be corrected by operation of the Code through retroactive remedial amendment.

.07 *Matters subject to excise taxes*. (1) Except as provided in paragraph (3) of this subsection, excise taxes and additional taxes, to the extent applicable, are not waived merely because the underlying failure has been corrected or because the taxes result from the correction. Thus, for example, the excise tax on certain excess contributions under § 4979 is not waived under these correction programs.

(2) Except as provided in paragraph (3) of this section, the correction programs are not available for events for which the Code provides tax consequences other than plan disqualification (such as the imposition of an excise tax or additional income tax). For example, funding deficiencies (failures to make the required contributions to a plan subject to § 412), prohibited transactions, and failures to file the Form 5500 cannot be corrected under the correction programs. However, if the event is also an Operational Failure (for example, if the terms of the plan document relating to plan loans to participants were not followed and loans made under the plan did not satisfy § 72(p)(2)), the correction programs will be available to correct the Operational Failure, even though the excise or income taxes generally still will apply.

(3) As part of VCP, if the failure involves the failure to satisfy the minimum required distribution requirements of § 401(a)(9), in appropriate cases, the Service will waive the excise tax under § 4974 applicable to plan participants. The waiver will be included in the compliance statement. The Plan Sponsor, as part of the submission, must request the waiver and in cases where the participant subject to the excise tax is an owner-employee, as defined in § 401(c)(3), or a 10 percent owner of a corporation, the Plan Sponsor must also provide an explanation supporting the request.

.08 *Correction for SEPs*. (1) *Correction for SEPs generally*. Generally, the correction for a SEP is expected to be similar to the correction required for a Qualified Plan with a similar Qualification Failure.

(2) *Special correction for SEPs*. Under VCSEP, in any case in which correction under section 6.08(1) is not feasible for a SEP or in any other case determined by the Service in its discretion (including failures relating to §§ 402(g), 415, and 401(a)(17), failures relating to deferral percentages, discontinuance of contributions to a SARSEP, and retention of overcontributions for cases in which there has been no violation of a statutory limitation), the Service may provide for a different correction. See section 12.07 for a special fee that may apply in such a case.

(3) *Correction of failure to satisfy deferral percentage test*. If the failure involves a violation of the deferral percentage test under § 408(k)(6)(A)(iii) applicable to a SARSEP, there are several methods to correct the failure, similar to the methods used in VCS and VCO. This failure may be corrected in one of the following ways:

(a) The Plan Sponsor may make contributions that are 100% vested to all eligible nonhighly compensated employees (to the extent permitted by § 415) necessary to raise the deferral percentage needed to pass the test. This amount may be calculated as either the same percentage of compensation or the same flat dollar amount (regardless of the terms of the SEP).

(b) The Plan Sponsor may effect distribution of excess contributions, adjusted for earnings through the date of correction, to highly compensated employees to correct the failure. The Plan Sponsor must also contribute to the SEP an amount equal to the total amount distributed. This amount must be allocated to (i) current employees who were nonhighly compensated employees in the year of the failure, (ii) current nonhighly compensated employees who were nonhighly compensated employees in the year of the failure, or (iii) employees (both current and former) who were nonhighly compensated employees in the year of the failure.

(4) *Treatment of undercontributions to a SEP*. (a) *Make-up contributions; earnings*. The Plan Sponsor should correct undercontributions to a SEP by contributing make-up amounts that are fully vested, adjusted for earnings credited from the date of the failure to the date of correction.

(b) *Earnings adjustment methods*. (i) The earnings rate generally is based on the investment results that would have applied to the corrective contribution if the failure had not occurred.

(ii) Insofar as SEP assets are held in IRAs, there is no earnings rate under the SEP as a whole. If the Plan Sponsor is unable to determine what the actual investment results would have been, a reasonable interest rate may be used.

.09 *Confidentiality and disclosure*. Because each correction program relates directly to the enforcement of the Code qualification requirements, the information received or generated by the Service under the program is subject to the confidentiality requirements of § 6103 and is not a written determination within the meaning of § 6110.

.10 *No effect on other law*. Correction under these programs has no effect on the rights of any party under any other law, including Title I of the Employee Retirement Income Security Act of 1974 ("ERISA").

PART IV. SELF-CORRECTION (SCP)

SECTION 7. IN GENERAL

The requirements of this section 7 are satisfied with respect to an Operational Failure if the Plan Sponsor of a Qualified Plan, a 403(b) Plan, or a SEP satisfies the requirements of section 8 (relating to insignificant Operational Failures) or, in the case of a Qualified Plan or a 403(b) Plan, section 9 (relating to significant Operational Failures).

SECTION 8. SELF-CORRECTION OF INSIGNIFICANT OPERATIONAL FAILURES

.01 *Requirements*. The requirements of this section 8 are satisfied with respect to an Operational Failure if the Operational Failure is corrected and, given all the facts and circumstances, the Operational Failure is insignificant. This section 8 is available for correcting an insignificant Operational Failure even if the plan or Plan Sponsor is Under Examination and even if the Operational Failure is discovered by an agent on examination.

.02 *Factors*. The factors to be considered in determining whether or not an Operational Failure under a plan is insignificant include, but are not limited to: (1) whether other failures occurred during the period being examined (for this purpose, a failure is not considered to have occurred more than once merely because more than one participant is affected by the failure); (2) the percentage of plan assets and contributions involved in the failure; (3) the number of years the failure occurred; (4) the number of participants affected relative to the total number of participants in the plan; (5) the number of

participants affected as a result of the failure relative to the number of participants who could have been affected by the failure; (6) whether correction was made within a reasonable time after discovery of the failure; and (7) the reason for the failure (for example, data errors such as errors in the transcription of data, the transposition of numbers, or minor arithmetic errors). No single factor is determinative. Additionally, factors (2), (4), and (5) should not be interpreted to exclude small businesses.

.03 *Multiple failures*. In the case of a plan with more than one Operational Failure in a single year, or Operational Failures that occur in more than one year, the Operational Failures are eligible for correction under this section 8 only if all of the Operational Failures are insignificant in the aggregate. Operational Failures that have been corrected under SCP in section 9 and VCP in sections 10 and 11 are not taken into account for purposes of determining if Operational Failures are insignificant in the aggregate.

.04 *Examples*. The following examples illustrate the application of this section 8. It is assumed, in each example, that the eligibility requirements of section 4 relating to SCP have been satisfied and that no Operational Failures occurred other than the Operational Failures identified below.

Example 1: In 1984, Employer X established Plan A, a profit-sharing plan that satisfies the requirements of § 401(a) in form. In 1999, the benefits of 50 of the 250 participants in Plan A were limited by § 415(c). However, when the Service examined Plan A in 2002, it discovered that, during the 1999 limitation year, the annual additions allocated to the accounts of 3 of these employees exceeded the maximum limitations under § 415(c). Employer X contributed $3,500,000 to the plan for the plan year. The amount of the excesses totaled $4,550. Under these facts, because the number of participants affected by the failure relative to the total number of participants who could have been affected by the failure, and the monetary amount of the failure relative to the total employer contribution to the plan for the 1999 plan year, are insignificant, the § 415(c) failure in Plan A that occurred in 1999 would be eligible for correction under this section 8.

Example 2: The facts are the same as in *Example 1*, except that the failure to satisfy § 415 occurred during each of the 1998, 1999, and 2000 limitation years. In addition, the three participants affected by the § 415 failure were not identical each year. The fact that the § 415 failures occurred during more than one limitation year did not cause the failures to be significant; accordingly, the failures are still eligible for correction under this section 8.

Example 3: The facts are the same as in *Example 1*, except that the annual additions of 18 of the 50 employees whose benefits were limited by § 415(c) nevertheless exceeded the maximum limitations under § 415(c) during the 1999 limitation year, and the amount of the excesses ranged from $1,000 to $9,000, and totaled $150,000. Under these facts, taking into account the number of participants affected by the failure relative to the total number of participants who could have been affected by the failure for the 1999 limitation year (and the monetary amount of the failure relative to the total employer contribution), the failure is significant. Accordingly, the § 415(c) failure in Plan A that occurred in 1999 is ineligible for correction under this section 8 as an insignificant failure.

Example 4: Employer J maintains Plan C, a money purchase pension plan established in 1992. The plan document satisfies the requirements of § 401(a) of the Code. The formula under the plan provides for an employer contribution equal to 10% of compensation, as defined in the plan. During its examination of the plan for the 1999 plan year, the Service discovered that the employee responsible for entering data into the employer's computer made minor arithmetic errors in transcribing the compensation data with respect to 6 of the plan's 40 participants, resulting in excess allocations to those 6 participants' accounts. Under these facts, the number of participants affected by the failure relative to the number of participants that could have been affected is insignificant, and the failure is due to minor data errors. Thus, the failure occurring in 1999 would be insignificant and therefore eligible for correction under this section 8.

Example 5: Public School maintains for its 200 employees a salary reduction 403(b) Plan (the "Plan") that satisfies the requirements of § 403(b). The business manager has primary responsibility for administering the Plan, in addition to other administrative functions within Public School. During the 1998 plan year, a former employee should have received an additional minimum required distribution of $278 under § 403(b)(10). Another participant received an impermissible hardship withdrawal of $2,500. Another participant made elective deferrals of $11,000, $1,000 of which was in excess of the § 402(g) limit. Under these facts, even though multiple failures occurred in a single plan year, the failures will be eligible for correction under this section 8 because in the aggregate the failures are insignificant.

SECTION 9. SELF-CORRECTION OF SIGNIFICANT OPERATIONAL FAILURES

.01 *Requirements*. The requirements of this section 9 are satisfied with respect to an Operational Failure (even if significant) if the Operational Failure is corrected and the correction is either completed or substantially completed (in accordance with section 9.04) by the last day of the correction period described in section 9.02.

.02 *Correction period*. (1) *End of correction period*. The last day of the correction period for an Operational Failure is the last day of the second plan year following the plan year for which the failure occurred. However, in the case of a failure to satisfy the requirements of § 401(k)(3), 401(m)(2), or 401(m)(9), the correction period does not end until the last day of the second plan year following the plan year that includes the last day of the additional period for correction permitted under § 401(k)(8) or 401(m)(6). If a 403(b) Plan does not have a plan year, the plan year is deemed to be the calendar year for purposes of this subsection.

(2) *Extension of correction period for Transferred Assets*. In the case of an Operational Failure that relates only to Transferred Assets, or to a plan assumed in connection with a corporate merger, acquisition or other similar employer transaction, the correction period does not end until the last day of the first plan year that begins after the corporate merger, acquisition, or other similar employer transaction between the Plan Sponsor and the sponsor of the transferor plan or the prior sponsor of an assumed plan.

(3) *Effect of examination*. The correction period for an Operational Failure that occurs for any plan year ends, in any event, on the first date the plan or Plan Sponsor is Under Examination for that plan year (determined without regard to the second sentence of section 9.02). (But see section 9.04 for special rules permitting completion of correction after the end of the correction period.)

.03 *Correction by plan amendment*. In order to complete correction by plan amendment (as permitted under section 4.06) during the correction period, the appropriate application (*i.e.*, the Form 5300 series or Form 6406) must be submitted before the end of the correction period.

.04 *Substantial completion of correction*. Correction of an Operational Failure is substantially completed by the last day of the correction period only if the requirements of either paragraph (1) or (2) are satisfied.

(1) The requirements of this paragraph (1) are satisfied if:

(a) during the correction period, the Plan Sponsor is reasonably prompt in identifying the Operational Failure, formulating a correction method, and initiating correction in a manner that demonstrates a commitment to completing

correction of the Operational Failure as expeditiously as practicable, and

(b) within 90 days after the last day of the correction period, the Plan Sponsor completes correction of the Operational Failure.

(2) The requirements of this paragraph (2) are satisfied if:

(a) during the correction period, correction is completed with respect to 85 percent of all participants affected by the Operational Failure, and

(b) thereafter, the Plan Sponsor completes correction of the Operational Failure with respect to the remaining affected participants in a diligent manner.

.05 *Examples*. The following examples illustrate the application of this section 9. Assume that the eligibility requirements of section 4 relating to SCP have been met.

Example 1: Employer Z established a qualified defined contribution plan in 1986 and received a favorable determination letter for TRA '86. During 1999, while doing a self-audit of the operation of the plan for the 1998 plan year, the plan administrator discovered that, despite the practices and procedures established by Employer Z with respect to the plan, several employees eligible to participate in the plan were excluded from participation. The administrator also found that for 1998 Operational Failures occurred because the elective deferrals of additional employees exceeded the § 402(g) limit and Employer Z failed to make the required top-heavy minimum contribution. During the 1999 plan year, the Plan Sponsor made corrective contributions on behalf of the excluded employees, distributed the excess deferrals to the affected participants, and made a top-heavy minimum contribution to all participants entitled to that contribution for the 1998 plan year. Each corrective contribution and distribution was credited with earnings at a rate appropriate for the plan from the date the corrective contribution or distribution should have been made to the date of correction. Under these facts, the Plan Sponsor has corrected the Operational Failures for the 1998 plan year within the correction period and thus satisfied the requirements of this section 9.

Example 2: Employer A established a qualified defined contribution plan, Plan A, in 1990 and received a favorable determination letter for TRA '86. In April 2002, Employer A purchased all of the stock of Employer B, a wholly-owned subsidiary of Employer C. Employees of Employer B participated in a qualified defined contribution plan sponsored by Employer C, Plan C. Following Employer A's review of Plan C, Employer A and Employer C agreed that Plan A would accept a transfer of plan assets attributable to the account balances of the employees of Employer B who had participated in Plan C. As part of this agreement, Employer C represented to Employer A that Plan C is tax qualified. Employers A and C also agreed that such transfer would be in accordance with § 414(l) and § 1.414(l)–1 and addressed issues related to costs associated with the transfer. Following the transaction, the employees of Employer B began participation in Plan A. Effective July 1, 2002, Plan A accepted the transfer of plan assets from Plan C. After the transfer, Employer A determined that all the participants in one division of Employer B had been incorrectly excluded from allocation of the profit sharing contributions for the 1998 and 1999 plan years. During 2003, Employer A made corrective contributions on behalf of the affected participants. The corrective contributions were credited with earnings at a rate appropriate for the plan from the date the corrective contribution should have been made to the date of correction and Employer A otherwise complied with the requirements of SCP. Under these facts, Employer A has, within the correction period, corrected the Operational Failures for the 1998 and 1999 plan years with respect to the assets transferred to Plan A, and thus satisfied the requirements of this section 9.

PART V. VOLUNTARY CORRECTION PROGRAM WITH SERVICE APPROVAL (VCP)

SECTION 10. VCP GENERAL PROCEDURES

.01 *VCP requirements*. The requirements of this section 10 are satisfied with respect to failures submitted in accordance with the requirements of this section 10 if the Plan Sponsor pays the compliance fee required under section 12 and implements the corrective actions and satisfies any other conditions in the compliance statement described in section 10.07.

.02 *Identification of failures*. VCP is not based upon an examination of the plan by the Service. Only the failures raised by the Plan Sponsor or failures identified by the Service in processing the application will be addressed under the program, and only those failures will be covered by the program. The Service will not make any investigation or finding under VCP concerning whether there are failures.

.03 *Availability of correction of a terminated plan*. Correction of Qualification Failures in a terminated plan may be made under VCP.

.04 *Effect of VCP submission on examination*. Because VCP does not arise out of an examination, consideration under VCP does not preclude or impede (under § 7605(b) or any administrative provisions adopted by the Service) a subsequent examination of the Plan Sponsor or the plan by the Service with respect to the taxable year (or years) involved with respect to matters that are outside the compliance statement. However, a Plan Sponsor's statements describing failures are made only for purposes of VCP and will not be regarded by the Service as an admission of a failure for purposes of any subsequent examination.

.05 *No concurrent examination activity*. Except in unusual circumstances, a plan that has been properly submitted under VCP will not be examined while the submission is pending. This practice regarding concurrent examinations does not extend to other plans of the Plan Sponsor. Thus, any plan of the Plan Sponsor that is not pending under VCP could be subject to examination.

.06 *Submission of determination letter application for plan amendments*. In any case in which correction of a Qualified Plan failure includes correction of a Plan Document Failure or correction of an Operational Failure by plan amendment as permitted under section 4.06, other than adoption of an amendment designated by the Service as a model amendment or a standardized prototype plan, the Plan Sponsor should submit a copy of the amendment, the appropriate application form (*i.e.*, Form 5300 series or Form 6406), and the appropriate user fee concurrently and to the same address as the VCP submission. The user fee for the determination letter application and the fee for a VCP submission which requires an up-front fee, for example, a VCO or VCS submission, must be submitted on separate certified or cashier's checks made payable to the U.S. Treasury.

.07 *Processing of submission*. (1) *Screening of submission*. Upon receipt of a submission under VCP, the Service will review whether the eligibility requirements of section 4 and the submission requirements of section 11 are satisfied. If the Service determines that a VCP submission is seriously deficient, the Service reserves the right to return the submission, including any compliance fee, without contacting the Plan Sponsor.

(2) *Review of submission*. Once the Service determines that the submission is complete under VCP, the Service will consult with the Plan Sponsor or the Plan Sponsor's representative to discuss the proposed corrections and the plan's administrative procedures.

(3) *Additional information required*. If additional information is required, a

Service representative will generally contact the Plan Sponsor or the Plan Sponsor's representative and explain what is needed to complete the submission. The Plan Sponsor will have 21 calendar days from the date of this contact to provide the requested information. If the information is not received within 21 days, the matter will be closed, the compliance fee will not be returned, and the case may be referred to Employee Plans Examinations. Any request for an extension of the 21-day time period must be made in writing within the 21-day time period and must be approved by the Service (by the applicable group manager).

(4) *Additional failures discovered after initial submission*. (a) A Plan Sponsor that discovers additional, unrelated Qualification or 403(b) Failures after its initial submission may request that such failures be added to its submission. However, the Service retains the discretion to reject the inclusion of such failures if the request is not timely, for example, if the Plan Sponsor makes its request when processing of the submission is substantially complete.

(b) If the Service discovers an unrelated Qualification or 403(b) Failure while the request is pending, the failure generally will be added to the failures under consideration. However, the Service retains the discretion to determine that a failure is outside the scope of the voluntary request for consideration because it was not voluntarily brought forward by the Plan Sponsor. In this case, if the additional failure is significant, all aspects of the plan may be examined and the rules pertaining to Audit CAP will apply. (See sections 13 and 14.)

(5) *Conference right*. If the Service initially determines that it cannot issue a compliance statement because the parties cannot agree upon correction or a change in administrative procedures, the Plan Sponsor (generally through the Plan Sponsor's representative) will be contacted by the Service representative and offered a conference with the Service. The conference can be held either in person or by telephone and must be held within 21 calendar days of the date of contact. The Plan Sponsor will have 21 calendar days after the date of the conference to submit additional information in support of the submission. Any request for an extension of the 21-day time period must be made in writing within the 21-day time period and must be approved by the Service (by the applicable group manager). Additional conferences may be held at the discretion of the Service.

(6) *Failure to reach resolution*. If the Service and the Plan Sponsor cannot reach agreement with respect to the submission, all aspects of the plan may be examined, and the Service may refer the submission to Employee Plans Examinations.

(7) *Issuance of compliance statement*. If agreement is reached, the Service will send to the Plan Sponsor an unsigned compliance statement specifying the corrective action required. Within 30 calendar days of the date the compliance statement is sent, a Plan Sponsor must sign the compliance statement and return it and any compliance fee required to be paid at the time that the compliance statement is signed (see sections 11.05 and 11.06 regarding timing of payment of compliance fee). The Service will then issue a signed copy of the compliance statement to the Plan Sponsor. If the Plan Sponsor does not send the Service the signed compliance statement (with the compliance fee) within 30 calendar days, the plan may be referred to Employee Plans Examinations for examination consideration.

(8) *Timing of correction*. The Plan Sponsor must implement the specific corrections and administrative changes set forth in the compliance statement within 150 days of the date of the compliance statement. Any request for an extension of this time period must be made in advance and in writing and must be approved by the Service.

(9) *Modification of compliance statement*. Once the compliance statement has been issued (based on the information provided), the Plan Sponsor cannot request a modification of the compliance terms except by a new request for a compliance statement. However, if the requested modification is minor and is postmarked no later than 30 days after the compliance statement is issued, the compliance fee for the modification will be the lesser of the original compliance fee or $1,250.

(10) *Verification*. Once the compliance statement has been issued, the Service may require verification that the corrections have been made and that any plan administrative procedures required by the statement have been implemented. This verification does not constitute an examination of the books and records of the employer or the plan (within the meaning of § 7605(b)). If the Service determines that the Plan Sponsor did not implement the corrections and procedures within the stated time period, the plan may be referred to Employee Plans Examinations for examination consideration.

.08 *Compliance statement*. (1) *General description of compliance statement*. The compliance statement issued for a VCP submission addresses the failures identified, the terms of correction, including any revision of administrative procedures, and the time period within which proposed corrections must be implemented, including any changes in administrative procedures. The compliance statement also provides that the Service will not treat the plan as failing to satisfy the applicable requirements of the Code on account of the failures described in the compliance statement if the conditions of the compliance statement are satisfied. Where current procedures are inadequate for operating the plan in conformance with the applicable requirements of the Code, the compliance statement will be conditioned upon the implementation of stated administrative procedures. The Service may prescribe appropriate administrative procedures in the compliance statement.

(2) *Compliance statement conditioned upon timely correction*. The compliance statement is conditioned on (i) there being no misstatement or omission of material facts in connection with the submission and (ii) the implementation of the specific corrections and satisfaction of any other conditions in the compliance statement.

(3) *Authority delegated*. Compliance statements (including any waiver of the excise tax under § 4974) are authorized to be signed by Area Managers reporting to the Director, Employee Plans Examinations, and managers within Employee Plans Rulings and Agreements, under the Tax Exempt and Government Entities Operating Division of the Service.

.09 *Effect of compliance statement on examination*. The compliance statement is binding upon both the Service and the Plan Sponsor or Eligible Organization (as defined in section 10.15(2)) with respect to the specific tax matters identified therein for the periods specified, but does not preclude or impede an examination of the plan by the Service relating to matters outside the compliance statement, even with respect to the same taxable year or years to which the compliance statement relates.

.10 *Processing of determination letter applications not submitted under VCP*. (1) The Service may process a determination letter application submitted under the determination letter program (including an application requested on Form 5310) concurrently with a VCP submission for the same plan. However, issuance of the determination letter in response to an application made on a Form 5310 will be suspended pending the closure of the VCP submission.

(2) A submission of a plan under the determination letter program does not constitute a submission under VCP. Thus, a Plan Sponsor that discovers a Qualification Failure in its plan must make a separate application under VCP. If the failure is discovered by the Service in connection with a determination letter application, the agent may issue a closing agreement with respect to the failures identified or, if appropriate, refer the case to Employee Plans Examinations. In either case, the fee structure in section 12, applicable to VCP, will not apply. Instead, the fee structure in section 14 relating to Audit CAP will apply. (See sections 13 and 14.)

.11 *Special rules relating to VCO*. (1) Under VCP, Operational Failures in a Qualified Plan may be corrected under the VCO rules in this subsection. VCO is available only if the plan's identified failures are all Operational Failures and only if the plan has a Favorable Letter.

(2) If the plan is not the subject of a Favorable Letter, or if the submission either includes a failure other than an Operational Failure or includes an egregious failure described in section 4.09, the submission will be converted from a submission under VCO to a submission under the VCP general procedures. The compliance fee will be retained and will be applied to the compliance fee required under the VCP general procedures. The Service retains the discretion to determine whether a submission is outside the scope of the special VCO rules even if the identified failures are Operational Failures and the plan has a Favorable Letter. The discretion will be applied only in rare and unusual circumstances.

.12 *Special rules relating to VCS*. (1) Under VCO, certain Operational Failures in a Qualified Plan may be corrected under the VCS rules in this subsection. VCS is available only if the plan's only identified Operational Failures are failures addressed in Appendix A or Appendix B of this revenue procedure and the failures are corrected in accordance with an applicable correction method set forth in Appendix A or Appendix B. Appropriate correction must be made for any Qualification Failure that results from the application of a VCS correction.

(2) The correction methods set forth in Appendix A and Appendix B are strictly construed and are the only acceptable correction methods for failures corrected under VCS. If the Plan Sponsor wishes to modify a correction method provided in Appendix A or Appendix B or to propose another method, the Plan Sponsor may not use VCS, but may request a compliance statement under the VCO procedure.

(3) VCS is not available if the Plan Sponsor has identified more than two failures in a single VCS request. If there are one or two failures that can be corrected under VCS and there are other failures that cannot be corrected under VCS, VCS is not available. The Service reserves the right to shift requests for consideration under VCS into VCO if the Plan Sponsor submits a second VCS request with respect to the same plan while the first VCS request is being considered or during the 12 months after the first VCS compliance statement is issued. Both VCS requests may be shifted into VCO if the first VCS request is still being considered.

(4) The Service will review a VCS request within 120 days of the date the submission is received and determined to be complete. If the Service determines that the request is acceptable, the Service will issue a compliance statement on the Plan Sponsor's proposed correction.

.13 *Special rules relating to Anonymous (John Doe) Submission Procedure*. (1) The Anonymous Submission Procedure permits submission of a Qualified or 403(b) Plan under VCP without initially identifying the applicable plan(s), the Plan Sponsor(s), or the Eligible Organization. The requirements of this revenue procedure relating to VCP, including sections 10, 11, and 12, apply to these submissions. However, information identifying the plan or the Plan Sponsor may be redacted (and the power of attorney statement and the penalty of perjury statement need not be included with the initial submission). For purposes of processing the submission, the State of the Plan Sponsor must be identified in the initial submission. Once the Service and the plan representative reach agreement with respect to the submission, the Service will contact the plan representative in writing indicating the terms of the agreement. The Plan Sponsor will have 21 calendar days from the date of the letter of agreement to identify the plan and Plan Sponsor. If the Plan Sponsor does not submit the identifying material (including the power of attorney statement and the penalty of perjury statement) within 21 calendar days of the letter of agreement, the matter will be closed and the compliance fee will not be returned.

(2) Notwithstanding section 10.05, until the plan(s) and Plan Sponsor(s) are identified to the Service, a submission under this subsection does not preclude or impede an examination of the Plan Sponsor or its plan(s). Thus, a plan submitted under the Anonymous Submission Procedure that comes Under Examination prior to the date the plan(s) and Plan Sponsor(s) identifying materials are received by the Service will no longer be eligible for either the Anonymous Submission Procedure or VCP.

(3) The Anonymous Submission Procedure is extended indefinitely.

.14 *Special rules relating to VCT*. A VCP submission for a 403(b) Plan is required to be made under the VCT procedure. A VCT submission is subject to the procedures of sections 10 and 11. A 403(b) Plan is not eligible for VCO or VCS.

.15 *Special rules relating to VCGroup*. (1) *General rules*. An Eligible Organization may submit a VCP request for a

Qualified Plan or a 403(b) Plan under the VCGroup procedure for Operational and Plan Document Failures under this subsection and may not submit an application under VCO, VCS, or VCT.

(2) *Eligible Organizations*. For purposes of VCGroup, the term "Eligible Organization" means either (a) a Sponsor (as that term is defined in section 4.09 of Rev. Proc. 2000–20, 2000–1 C.B. 553) of a master or prototype plan, (b) an insurance company or other entity that has issued annuity contracts or provides services with respect to assets for 403(b) Plans, or (c) an entity that provides its clients with administrative services with respect to Qualified Plans or 403(b) Plans. An Eligible Organization is not eligible for VCGroup unless the submission includes a failure resulting from a systemic error involving the Eligible Organization that affects at least 20 plans and that results in at least 20 plans implementing correction. If, at any time before the Service provides an unsigned compliance statement, the number of plans falls below 20, the Eligible Organization must notify the Service that it is no longer eligible for VCGroup (and the compliance fee will be retained).

(3) *Special VCGroup procedures*. (a) A VCGroup submission is subject to the same procedures as any VCP submission in accordance with sections 10 and 11, except that the Eligible Organization is responsible for performing the procedural obligations imposed on the Plan Sponsor under sections 10 and 11.

(b) When an Eligible Organization under VCGroup receives an unsigned compliance statement on the proposed correction and agrees to the terms of the compliance statement, the Eligible Organization must return to the Service within 120 calendar days not only the signed compliance statement and any additional compliance fee under section 12.06, but also a list containing (i) the employers' tax identification numbers for the Plan Sponsors of the plans to whom the compliance statement may be applicable and (ii) the plans by name, plan number, type of plan, number of plan participants, and trust's tax identification numbers, if applicable, along with (iii) a power of attorney (which may be a limited power of attorney) from each of the Plan Sponsors authorizing the Eligible Organization or its representative to act on the Plan Sponsor's behalf with respect to the items in the compliance statement and (iv) a certification that each Plan Sponsor timely filed the Form 5500 return for each plan. Only those plans for which correction is actually made within 240 calendar days of the date of the signed compliance statement (or within such longer period as may be agreed to by the Service at the request of the Eligible Organization) will be covered by that statement.

(c) Notwithstanding section 10.04, until the Eligible Organization provides the Service with the information of section 10.14(3)(b)(i) through (iv) with respect to a Plan Sponsor and its plan(s), a VCGroup submission does not preclude or impede an examination of the Plan Sponsor or its plan(s).

(4) *VCGroup implementation*. The VCGroup procedure is being implemented on a provisional basis, and the Service and Treasury invite comments on the operation of the VCGroup procedure.

.16 *Special rules relating to VCSEP*. A VCP submission for a SEP is required to be made under the VCSEP procedure. A VCSEP submission is subject to the procedures of sections 10 and 11. A SEP Plan is not eligible for VCO or VCS.

.17 *Multiemployer and multiple employer plans*. (1) In the case of a multiemployer or multiple employer plan, the plan administrator (rather than any contributing or adopting employer) must request consideration of the plan under the programs. The request must be with respect to the plan, rather than a portion of the plan affecting any particular employer.

(2) If a VCP submission for a multiemployer or multiple employer plan has failures that apply to fewer than all of the employers under the plan, the plan administrator may choose to have the compliance fee (in section 12) or sanction (in section 14) calculated separately for each employer based on the assets attributable to that employer, rather than being attributable to the assets of the entire plan. Thus, the plan administrator may choose to apply the provisions of this paragraph where the failure is attributable in whole or in part to data, information, actions, or inactions that are within the control of the employers rather than the multiemployer or multiple employer plan (such as attribution in whole or in part to the failure of an employer to provide the plan administrator with full and complete information).

SECTION 11. APPLICATION PROCEDURES FOR VCP

.01 *General rules*. The requirements of this section 11 are satisfied if the request for a compliance statement from the Service under VCP satisfies the informational and other requirements of this section 11. In general, a request under VCP consists of a letter from the Plan Sponsor (which may be a letter from the Plan Sponsor's representative) or Eligible Organization (or representative) to the Service that contains a description of the failures, a description of the proposed methods of correction, and other procedural items, and includes supporting information and documentation as described below.

.02 *Submission requirements*. The letter from the Plan Sponsor or the Plan Sponsor's representative must contain the following:

(1) A complete description of the failures and the years in which the failures occurred, including closed years (that is, years for which the statutory period has expired).

(2) A description of the administrative procedures in effect at the time the failures occurred.

(3) An explanation of how and why the failures arose.

(4) A detailed description of the method for correcting the failures that the Plan Sponsor has implemented or proposes to implement. Each step of the correction method must be described in narrative form. The description must include the specific information needed to support the suggested correction method. This information includes, for example, the number of employees affected and the expected cost of correction (both of which may be approximated if the exact number cannot be determined at the time of the request), the years involved, and calculations or assumptions the Plan Sponsor used to determine the amounts needed for correction. See section 10.11 for special procedures regarding VCS.

(5) A description of the methodology that will be used to calculate earnings

or actuarial adjustments on any corrective contributions or distributions (indicating the computation periods and the basis for determining earnings or actuarial adjustments, in accordance with section 6.02(4)).

(6) Specific calculations for each affected employee or a representative sample of affected employees. The sample calculations must be sufficient to demonstrate each aspect of the correction method proposed. For example, if a Plan Sponsor requests a compliance statement with respect to a failure to satisfy the contribution limits of § 415(c) and proposes a correction method that involves elective contributions (whether matched or unmatched) and matching contributions, the Plan Sponsor must submit calculations illustrating the correction method proposed with respect to each type of contribution. As another example, with respect to a failure to satisfy the ADP test in § 401(k)(3), the Plan Sponsor must submit the ADP test results both before the correction and after the correction.

(7) The method that will be used to locate and notify former employees and beneficiaries, or an affirmative statement that no former employees or beneficiaries were affected by the failures or will be affected by the correction.

(8) A description of the measures that have been or will be implemented to ensure that the same failures will not recur.

(9) A statement that, to the best of the Plan Sponsor's knowledge, neither the plan nor the Plan Sponsor is Under Examination.

(10) If a submission includes a failure that refers to Transferred Assets and occurred prior to the transfer, a description of the transaction (including the dates of the employer change and the plan transfer).

(11) A statement (if applicable) that the plan is currently being considered in a determination letter application. If the request for a determination letter is made while a request for consideration under VCP is pending, the Plan Sponsor must update the VCP request to add this information.

.03 *Submission requirements under special procedures*. The letter from the Plan Sponsor or the Plan Sponsor's representative must also contain the following:

(1) *VCS*. In the case of a VCS submission, a statement that it is a VCS request, a description of the applicable correction in accordance with Appendix A or Appendix B, and a statement that the Plan Sponsor proposes to implement (or has implemented) the correction(s).

(2) *VCT*. In the case of a VCT submission, a statement that the Plan Sponsor has contacted all other entities involved with the plan and has been assured of cooperation in implementing the applicable correction, to the extent necessary. For example, if the plan's failure is the failure to satisfy the requirements of § 403(b)(1)(E) on elective deferrals, the Plan Sponsor must, prior to making the VCT application, contact the insurance company or custodian with control over the plan's assets to assure cooperation in effecting a distribution of the excess deferrals and the earnings thereon. An application under VCT must also contain a statement as to the type of employer (*e.g.*, a tax-exempt organization described in § 501(c)(3)) submitting the VCT application.

(3) *VCGroup*. A VCGroup submission must be signed by the Eligible Organization or the Eligible Organization's authorized representative and accompanied by a copy of the relevant portions of the plan document(s).

(4) *VCSEP*. In the case of a VCSEP submission, a statement that it is a VCSEP request.

.04 *Required documents*. A VCP submission must be accompanied by the following documents:

(1) *Form 5500 or similar information*. (a) *VCP*. In the case of the general procedures under VCP, a copy of the most recently filed Form 5500 series return.

(b) *VCO and VCS*. In the case of a VCO or VCS submission, a copy of the first page and a copy of the page containing employee census information (currently, line 7f of the 1999 Form 5500) and a copy of the page containing the total amount of plan assets (currently, line 31f of the 1999 Form 5500) or the most recently filed Form 5500 series return.

(c) *Anonymous submission*. In the case of a submission under the Anonymous Submission Procedure, the employee census and plan asset information may be redacted and replaced by numbers that are rounded up.

(d) *VCT*. In the case of a VCT submission, if Form 5500 is inapplicable, the information generally included on the first two pages of Form 5500, including the name and number of the plan, and the employer's Employer Identification Number.

(e) *VCSEP*. In the case of a VCSEP submission, if Form 5500 is inapplicable, the information generally included on the first two pages of Form 5500, including the name and number of the plan, and the employer's Employer Identification Number.

(2) *Plan document*. A copy of the relevant portions of the plan document. For example, in a case involving improper exclusion of eligible employees from a profit-sharing plan with a cash or deferred arrangement, relevant portions of the plan document include the eligibility, allocation, and cash or deferred arrangement provisions of the basic plan document (and the adoption agreement, if applicable), along with applicable definitions in the plan. If the plan is a 403(b) Plan and a plan document is not available, written descriptions of the plan, and sample salary reduction agreements if relevant. In the case of a SEP, submit the entire plan document.

(3) *Determination letter application*. In any case in which correction of a Qualified Plan failure includes correction of a Plan Document Failure or correction of an Operational Failure by plan amendment as permitted under section 4.06, other than adoption of an amendment designated by the Service as a model amendment or a standardized or prototype plan, the Plan Sponsor must submit the amendment, the appropriate application form (*i.e.*, Form 5300 series or Form 6406), and the appropriate user fee. The user fee for the determination letter application and the fee for a VCP submission which requires an up-front fee, for example, a VCO or VCS submission, must be submitted on separate certified or cashier's checks made payable to the U.S. Treasury.

(4) *Copy of Favorable Letter for VCO, VCS, or VCSEP*. In the case of VCO, VCS, or VCSEP, a copy of a Favorable Letter.

.05 *Date VCP fee due generally*. Except as provided in section 11.06, the VCP fee under section 12 is due at the

time the compliance statement is signed by the Plan Sponsor and returned to the Service. All fees must be submitted by certified or cashier's check made payable to the U.S. Treasury.

.06 *Fee due earlier for VCO, VCS, Anonymous Submission, VCGroup, and VCSEP*. In the case of a VCO or VCS submission, the appropriate fee described in section 12.02 or 12.03 must be included with the submission. In the case of a submission made under the Anonymous Submission Procedure, VCGroup, or VCSEP, the initial fee described in section 12.04(1), 12.06, or 12.07(1), respectively, must be included with the submission (and any additional fee is due at the time provided in section 11.05).

.07 *Signed submission*. The submission must be signed by the Plan Sponsor or the sponsor's authorized representative.

.08 *Power of attorney requirements*. To sign the submission or to appear before the Service in connection with the submission, the Plan Sponsor's representative must comply with the requirements of section 9.02(11) and (12) of Rev. Proc. 2002–4, 2002–1 I.R.B. 127.

.09 *Penalty of perjury statement*. The following declaration must accompany a request and any factual information or change in the submission at a later time: **"Under penalties of perjury, I declare that I have examined this submission, including accompanying documents, and, to the best of my knowledge and belief, the facts presented in support of this submission are true, correct, and complete."** The declaration must be signed by the Plan Sponsor, not the Plan Sponsor's representative.

.10 *Checklist*. The Service will be able to respond more quickly to a VCP request if the request is carefully prepared and complete. The checklist in Appendix C is designed to assist Plan Sponsors and their representatives in preparing a submission that contains the information and documents required under this revenue procedure. The checklist in Appendix C must be completed, signed, and dated by the Plan Sponsor or the Plan Sponsor's representative, and should be placed on top of the submission. A photocopy of this checklist may be used.

.11 *Designation*. The letter to the Service should be designated "VCP", "VCO", "VCS", "VCT", "VCSEP", or "VCGroup", as appropriate, in the upper right hand corner of the letter. In addition, if the submission is an Anonymous Submission, the letter should also be designated "Anonymous Submission Procedure".

.12 *VCP mailing address*. All VCP submissions should be mailed to:

Internal Revenue Service
Attention: T:EP:RA:VC
P.O. Box 27063
McPherson Station
Washington, D.C. 20038

.13 *Maintenance of copies of submissions*. Plan Sponsors and their representatives should maintain copies of all correspondence submitted to the Service with respect to their VCP requests.

SECTION 12. VCP FEES

.01 *VCP general procedure compliance fee*. (1) *Compliance fee chart*. Except as otherwise provided in this section 12, the compliance fee for an application under VCP is determined in accordance with the chart below. All fees must be submitted by certified or cashier's check made payable to the U.S. Treasury. The chart contains a graduated range of fees based on the size of the plan and the number of participants. Each range includes a minimum amount, a maximum amount, and a presumptive amount. In each case, the minimum amount is the applicable VCO fee in section 12.02. It is expected that in most instances the compliance fee imposed will be at or near the presumptive amount in each range; however, the fee may be a higher or lower amount within the range, depending on the factors in paragraph (2) below.

VCP GENERAL PROCEDURES COMPLIANCE FEES		
# of participants	Fee range	Presumptive Amount
10 or fewer	VCO fee* to $4,000	$2,000
11 to 50	VCO fee* to $8,000	$4,000
51 to 100	VCO fee* to $12,000	$6,000
101 to 300	VCO fee* to $16,000	$8,000
301 to 1,000	VCO fee* to $30,000	$15,000
Over 1,000	VCO fee* to $70,000	$35,000

* Items marked by asterisk refer to the VCO compliance fee that would apply under section 12.02 if the plan had been submitted under VCO.

(2) *Factors considered*. Except as provided in section 12.01(3) with respect to nonamenders and section 12.01(4) relating to egregious failures, consideration of whether the compliance fee should be equal to, greater than, or less than the presumptive amount will depend on factors relating to the nature, extent, and severity of the failure. These factors include: (a) whether the failure is a failure to satisfy the requirements of § 401(a)(4), § 401(a)(26), or § 410(b), (b) whether the plan has both Operational and Plan Document Failures, (c) the period over which the violation occurred (for example, the time that has elapsed since the end of the applicable remedial amendment period under § 401(b) for a Plan Document Failure), (d) the extent to which the plan has accepted Transferred Assets, and the extent to which the failures relate to the Transferred Assets and occurred before the transfer, and (e) whether the plan has a Favorable Letter.

(3) *VCP fee for nonamenders*. The VCP compliance fee for a submission that includes only a Plan Document Failure that is solely a failure to amend the plan timely to comply with required tax law changes is determined in accordance with section 12.01(1), as follows:

(a) GUST (for plans filed after September 3, 2002), UCA or OBRA '93 model amendments only — the fee is the halfway point between the minimum amount and the presumptive amount of the applicable fee range.

(b) TRA '86 — the fee is the presumptive amount of the applicable fee range, and clause (a) does not apply.

(c) TEFRA, DEFRA, or REA — the fee is the halfway point between the presumptive amount and the maximum amount of the applicable fee range, and clauses (a) and (b) do not apply.

(d) ERISA — the fee is the maximum amount of the applicable fee range, and clauses (a), (b), and (c) do not apply.

(4) *Egregious failures*. In cases involving failures that are egregious (as described in section 4.09), (a) the maximum compliance fee applicable to the plan under the chart in 12.01(1) is increased to 40 percent of the Maximum Payment Amount and (b) no presumptive amount applies.

.02 *VCO fee*. Unless VCS is applicable, the VCO compliance fee depends on the assets of the plan and the number of plan participants.

(1) The fee for a plan with assets of less than $500,000 and no more than 1,000 plan participants is $500.

(2) The fee for a plan with assets of at least $500,000 and no more than 1,000 plan participants is $1,250.

(3) The fee for a plan with more than 1,000 plan participants but fewer than 10,000 plan participants is $5,000.

(4) The fee for a plan with 10,000 or more plan participants is $10,000.

.03 *VCS fee*. The VCS compliance fee is $350.

.04 *Fee for Anonymous Submission*. The compliance fee for the Anonymous Submission Procedure is the fee applicable under other provisions of this section 12 (*i.e.*, the fee under section 12.01 for VCP general procedures, the fee under section 12.02 for VCO, or the fee under section 12.05 for VCT).

(1) The initial portion of the fee is the amount determined under section 12.02 (for the VCP general procedures or VCO) or 12.05(2) (for VCT).

(2) The additional fee, if any, is the fee determined under section 12.01 or 12.05, if applicable, reduced by the fee in section 12.04(1).

.05 *VCT Fee*. (1) *VCT compliance fee*. The applicable VCT compliance fee depends on the type of failure and, generally, the number of employees of the employer.

(2) *Fee for Operational Failures*. Subject to section 12.05(3), the compliance fee for submissions that include only Operational Failures is as follows:

(a) The fee for an employer with fewer than 25 employees is $500.

(b) The fee for an employer with at least 25 and no more than 1,000 employees is $1,250.

(c) The fee for an employer with more than 1,000 employees but less than 10,000 is $5,000.

(d) The fee for an employer with 10,000 or more employees is $10,000.

(3) *Fee for certain Excess Amounts*. Subject to section 12.05(6), the compliance fee for Excess Amounts that are corrected pursuant to section 6.05(2)(b) is equal to the sum of (a) the applicable fee described in section 12.05(2), plus (b) ten percent of the Excess Amounts, adjusted for earnings through the date of the VCT application, contributed or allocated in the calendar year of the VCT application and in the three calendar years prior thereto. If there is a failure to satisfy both the § 403(b)(2) and § 415 limits with respect to a single employee for a year, the fee will take into account only the larger Excess Amount.

(4) *Fee for Demographic and Eligibility Failures*. (a) Subject to section 12.05(6), the compliance fee for a 403(b) Plan with failures that include any Demographic or Employer Eligibility Failure is determined in accordance with the VCP fee table in section 12.01(1), except that (i) the reference to VCO fees is changed to refer to the VCT compliance fee for Operational Failures in section 12.05(2) above and (ii) the fee is determined with reference to the number of employees rather than participants.

(b) In addition to the types of factors listed in section 12.01(2), factors considered in determining the compliance fee for failures that include any Demographic or Employer Eligibility Failure under VCT include: (i) whether the failures include a Demographic Failure, (ii) whether the 403(b) Plan has a combination of two or more types of failures (Operational, Demographic, and Employer Eligibility); and (iii) the period of time over which the failure occurred.

(5) *Fee for multiple failures*. If correction is requested for multiple failures, the compliance fee is determined in accordance with the table below.

Multiple Operational Failures	Fee described in section 12.05(2)
Multiple Demographic or Eligibility Failures	Fee described in section 12.05(4)
Combination of Operational and Demographic or Eligibility Failures	Fee described in section 12.05(4)
Operational Failure(s) with section 6.05(2)(b) correction of Excess Amounts	Fee described in section 12.05(3)
Demographic or Eligibility Failures and Operational Failures including section 6.05(2)(b) correction of Excess Amounts	Fee described in section 12.05(3), substituting section 12.05(4) fee for section 12.05(2) fee

(6) *Fee for egregious failures*. In cases involving failures that are egregious, the maximum VCT compliance fee applicable to the plan is increased to 40 percent of the Total Sanction Amount and no presumptive amount applies.

.06 *VCGroup fees*. The compliance fee for a VCGroup submission is based on the number of plans to which the compliance statement is applicable. The initial fee is $10,000. In the case of a submission with only corrections under Appendix A or B, an additional fee is due equal to the product of the number of plans in excess of 20 times $125, up to a maximum of $40,000; in any other case, the additional fee is equal to the product of the number of plans in excess of 20 times $250, up to a maximum of $90,000.

.07 *VCSEP fees*. The applicable VCSEP compliance fee is the same as the fee for VCP in section 12.01, subject to the following:

(1) In the case of a SEP with Operational Failures only, the compliance fee is determined in accordance with the VCO fee schedule in section 12.02, except that the fee is determined solely on the basis of the number of plan participants.

(2) In any case in which a SEP correction is not similar to a correction for a similar Qualification Failure (as provided under section 6.08(1)), the Service may impose an additional fee. If the failure involves an overcontribution to a SEP that is not the result of a failure to satisfy a statutory limit on contributions to a SEP and the Plan Sponsor retains the overcontribution in the SEP, a fee equal to at least ten percent of the overcontribution excluding earnings will be imposed. This is in addition to the VCSEP compliance fee.

.08 *Establishing amount of assets and number of plan participants*. Compliance fees under this section 12 are calculated by the Plan Sponsor using the numbers from the most recently filed Form 5500 series to establish the fee. Thus, with respect to the 1999 Form 5500, the Plan Sponsor would use the number shown on line 7(f) (or the equivalent line on the Form 5500 C/R or EZ) to establish the number of plan participants and would use line 31(f) (or the equivalent line on the Form 5500 C/R or EZ) to establish the amount of plan assets. If the submission involves a plan with Transferred Assets and no new incidents of the failure occurred after the end of the second plan year that begins after the corporate merger, acquisition, or other similar employer transaction, the Plan Sponsor may calculate the amount of plan assets and number of plan participants based on the Form 5500 information that would have been filed by the Plan Sponsor for the plan year that includes the employer transaction if the Transferred Assets were maintained as a separate plan. In the case of a SEP not required to file a Form 5500, the Plan Sponsor may use other reasonable information to determine the amount of plan assets and the number of participants.

PART VI. CORRECTION ON AUDIT (AUDIT CAP)

SECTION 13. DESCRIPTION OF AUDIT CAP

.01 *Audit CAP requirements*. If the Service identifies a Qualification or 403(b) Failure (other than a failure that has been corrected in accordance with SCP or VCP) upon an Employee Plans or Exempt Organizations examination of a Qualified Plan, 403(b) Plan, or SEP, the requirements of this section 13 are satisfied with respect to the failure if the Plan Sponsor corrects the failure, pays a sanction in accordance with section 14, satisfies any additional requirements of section 13.03, and enters into a closing agreement with the Service.

.02 *Payment of sanction*. Payment of the sanction under section 14 generally is required at the time the closing agreement is signed. All sanction amounts should be submitted by certified or cashier's check made payable to the U.S. Treasury.

.03 *Additional requirements*. Depending on the nature of the failure, the Service will discuss the appropriateness of the plan's existing administrative procedures with the Plan Sponsor. If existing administrative procedures are inadequate for operating the plan in conformance with the applicable requirements of the Code, the closing agreement may be conditioned upon the implementation of stated procedures. In addition, for Qualified Plans, the Plan Sponsor may be required to obtain a Favorable Letter before the closing agreement is signed unless the Service determines that it is unnecessary based on the facts and circumstances (for example, because the plan already has a Favorable Letter and no significant amendments are adopted). If a Favorable Letter is required, the Plan Sponsor is required to pay the applicable user fee for obtaining the letter.

.04 *Failure to reach resolution*. If the Service and the Plan Sponsor cannot reach an agreement with respect to the correction of the failure(s) or the amount of the sanction, the plan will be disqualified or, in the case of a 403(b) Plan or SEP, will not have reliance on this revenue procedure.

.05 *Effect of closing agreement*. A closing agreement constitutes an agreement between the Service and the Plan Sponsor that is binding with respect to the tax matters identified therein for the periods specified.

.06 *Other procedural rules*. The procedural rules for Audit CAP are set forth in Internal Revenue Manual ("IRM") 7.2.2, EPCRS.

SECTION 14. AUDIT CAP SANCTION

.01 *Determination of sanction*. The sanction under Audit CAP is a negotiated percentage of the Maximum Payment Amount. For 403(b) Plans and SEPs, the sanction is a negotiated percentage of the Total Sanction Amount. Sanctions will not be excessive and will bear a reasonable relationship to the nature, extent, and severity of the failures, based on the factors below.

.02 *Factors considered*. Factors include: (1) the steps taken by the Plan Sponsor to ensure that the plan had no failures, (2) the steps taken to identify failures that may have occurred, (3) the extent to which correction had progressed before the examination was initiated, including full correction, (4) the amount of the fee the Plan Sponsor would have paid under section 12 for correcting the failures, (5) the number and type of employees affected by the failure, (6) the number of nonhighly compensated employees who would be adversely affected if the plan were not treated as qualified or as satisfying the requirements of § 403(b) or § 408(k), (7) whether the failure is a failure to satisfy the requirements of § 401(a)(4), § 401(a)(26), or § 410(b), either directly or through § 403(b)(12), (8) the period over which

the failure occurred (for example, the time that has elapsed since the end of the applicable remedial amendment period under § 401(b) for a Plan Document Failure), and (9) the reason for the failure (for example, data errors such as errors in transcription of data, the transposition of numbers, or minor arithmetic errors). Factors relating only to Qualified Plans also include: (1) whether the plan is the subject of a Favorable Letter, (2) whether the plan has both Operational and other failures, and (3) the extent to which the plan has accepted Transferred Assets, and the extent to which failures relate to Transferred Assets and occurred before the transfer. Additional factors relating only to 403(b) Plans include: (1) whether the plan has a combination of Operational, Demographic, or Employer Eligibility Failures, (2) the extent to which the failure relates to Excess Amounts, and (3) whether the failure is solely an Employer Eligibility Failure.

.03 *Transferred Assets*. If the examination involves a plan with Transferred Assets and the Service determines that no new incidents of the failures that relate to the Transferred Assets occur after the end of the second plan year that begins after the corporate merger, acquisition, or other similar employer transaction, the sanction under Audit CAP will not exceed the sanction that would apply if the Transferred Assets were maintained as a separate plan.

PART VII. EFFECT ON OTHER DOCUMENTS; EFFECTIVE DATE; PAPERWORK REDUCTION ACT

SECTION 15. EFFECT ON OTHER DOCUMENTS

.01 *Revenue procedure 2001–17 modified and superseded*. Rev. Proc. 2001–17 is modified and superseded by this revenue procedure.

SECTION 16. EFFECTIVE DATE

This revenue procedure is effective July 22, 2002.

SECTION 17. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1673.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collection of information in this revenue procedure is in sections 4.06, 6.02(5)(c), 6.05, 10.01, 10.02, 10.05–10.07, 11.02–11.04, 11.07–11.13, 13.01, section 2.01–2.07 of Appendix B, and Appendix C. This information is required to enable the Commissioner, Tax Exempt and Government Entities Division of the Internal Revenue Service to make determinations regarding the issuance of various types of closing agreements and compliance statements. This information will be used to issue closing agreements and compliance statements to allow individual plans to continue to maintain their tax qualified and tax-deferred status. As a result, favorable tax treatment of the benefits of the eligible employees is retained. The likely respondents are individuals, state or local governments, business or other for-profit institutions, nonprofit institutions, and small businesses or organizations.

The estimated total annual reporting and/or recordkeeping burden is 56,272 hours.

The estimated annual burden per respondent/recordkeeper varies from .5 to 42.5 hours, depending on individual circumstances, with an estimated average of 13.11 hours. The estimated number of respondents and/or recordkeepers is 4,292.

The estimated frequency of responses is occasional.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. § 6103.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Maxine Terry and Carlton Watkins of the Tax Exempt and Government Entities Division. For further information concerning this revenue procedure, please contact the Employee Plans' taxpayer assistance telephone service at 1–877–829–5500 between 8:30 a.m. and 6:30 p.m., Eastern Time, Monday through Friday (a toll-free number). Ms. Terry and Mr. Watkins may be reached at (202) 283–9888 (not a toll-free number).

APPENDIX A

OPERATIONAL FAILURES AND CORRECTIONS UNDER VCS

.01 *General rule*. This appendix sets forth Operational Failures relating to Qualified Plans and corrections under VCS in accordance with section 10.11. In each case, the method described corrects the Operational Failure identified in the headings below. Corrective allocations and distributions should reflect earnings and actuarial adjustments in accordance with section 6.02(4). The correction methods in this appendix are acceptable under SCP and VCP (including VCS). Additionally, the correction methods and the earnings adjustment methods in Appendix B are acceptable under SCP and VCP (including VCS but not VCT).

.02 *Failure to properly provide the minimum top-heavy benefit under § 416 of the Code to non-key employees*. In a defined contribution plan, the permitted correction method is to properly contribute and allocate the required top-heavy minimums to the plan in the manner provided for in the plan on behalf of the non-key employees (and any other employees required to receive top-heavy allocations under the plan). In a defined benefit plan, the minimum required benefit must be accrued in the manner provided in the plan.

.03 *Failure to satisfy the ADP test set forth in § 401(k)(3), the ACP test set forth in § 401(m)(2), or the multiple use test of § 401(m)(9)*. The permitted correction method is to make qualified nonelective contributions (QNCs) (as defined in § 1.401(k)–1(g)(13)(ii)) on behalf of the nonhighly compensated employees to the extent necessary to raise the actual deferral percentage or actual contribution percentage of the nonhighly compensated employees to the percentage needed to pass the test or tests. The contributions must be made on behalf of all eligible nonhighly compensated employees (to the

extent permitted under § 415) and must either be the same flat dollar amount or the same percentage of compensation. QNCs contributed to satisfy the ADP test need not be matched. Employees who would have been eligible for a matching contribution had they made elective contributions must be counted as eligible employees for the ACP test, and the plan must satisfy the ACP test. Under this VCS correction method, a plan may not be treated as two separate plans, one covering otherwise excludable employees and the other covering all other employees (as permitted in § 1.410(b)–6(b)(3)) in order to reduce the number of employees eligible to receive QNCs. Likewise, under this VCS correction method, the plan may not be restructured into component plans (as permitted in § 1.401(k)–1(h)(3)(iii) for plan years before January 1, 1992) in order to reduce the number of employees eligible to receive QNCs.

.04 *Failure to distribute elective deferrals in excess of the § 402(g) limit (in contravention of § 401(a)(30))*. The permitted correction method is to distribute the excess deferral to the employee and to report the amount as taxable in the year of deferral and in the year distributed. In accordance with § 1.402(g)–1(e)(1)(ii), a distribution to a highly compensated employee is included in the ADP test; a distribution to a nonhighly compensated employee is not included in the ADP test.

.05 *Exclusion of an eligible employee from all contributions or accruals under the plan for one or more plan years*. The permitted correction method is to make a contribution to the plan on behalf of the employees excluded from a defined contribution plan or to provide benefit accruals for the employees excluded from a defined benefit plan. If the employee should have been eligible to make an elective contribution under a cash or deferred arrangement, the employer must make a QNC (as defined in § 1.401(k)–1(g)(13)(ii)) to the plan on behalf of the employee that is equal to the actual deferral percentage for the employee's group (either highly compensated or nonhighly compensated). If the employee should have been eligible to make employee contributions or for matching contributions (on either elective contributions or employee contributions), the employer must make a QNC to the plan on behalf of the employee that is equal to the actual contribution percentage for the employee's group (either highly compensated or nonhighly compensated). Contributing the actual deferral or contribution percentage for such employees eliminates the need to rerun the ADP or ACP test to account for the previously excluded employees. Under this VCS correction method, a plan may not be treated as two separate plans, one covering otherwise excludable employees and the other covering all other employees (as permitted in § 1.410(b)–6(b)(3)) in order to reduce the amount of QNCs. Likewise, restructuring the plan into component plans under § 1.401(k)–1(h)(3)(iii) is not permitted in order to reduce the amount of QNCs.

.06 *Failure to timely pay the minimum distribution required under § 401(a)(9)*. In a defined contribution plan, the permitted correction method is to distribute the required minimum distributions. The amount to be distributed for each year in which the failure occurred should be determined by dividing the adjusted account balance on the applicable valuation date by the applicable distribution period. For this purpose, adjusted account balance means the actual account balance, determined in accordance with § 1.401(a)(9)–5 Q&A F–3 of the regulations, reduced by the amount of the total missed minimum distributions for prior years. In a defined benefit plan, the permitted correction method is to distribute the required minimum distributions, plus an interest payment representing the loss of use of such amounts.

.07 *Failure to obtain participant and/or spousal consent for a distribution subject to the participant and spousal consent rules under §§ 401(a)(11), 411(a)(11) and 417*. The permitted correction method is to give each affected participant a choice between providing informed consent for the distribution actually made or receiving a qualified joint and survivor annuity. In order to use this VCS correction method, the Plan Sponsor must have contacted each affected participant and spouse (to whom the participant was married at the annuity starting date) and received responses from each such individual before requesting consideration under VCS. In the event that participant and/or spousal consent is required but cannot be obtained, the participant must receive a qualified joint and survivor annuity based on the monthly amount that would have been provided under the plan at his or her retirement date. This annuity may be actuarially reduced to take into account distributions already received by the participant. However, the portion of the qualified joint and survivor annuity payable to the spouse upon the death of the participant may not be actuarially reduced to take into account prior distributions to the participant. Thus, for example, if in accordance with the automatic qualified joint and survivor annuity option under a plan, a married participant who retired would have received a qualified joint and survivor annuity of $600 per month payable for life with $300 per month payable to the spouse upon the participant's death but instead received a single-sum distribution equal to the actuarial present value of the participant's accrued benefit under the plan, then the $600 monthly annuity payable during the participant's lifetime may be actuarially reduced to take the single-sum distribution into account. However, the spouse must be entitled to receive an annuity of $300 per month payable for life beginning at the participant's death.

.08 *Failure to satisfy the § 415 limits in a defined contribution plan*. The permitted correction for failure to limit annual additions (other than elective deferrals and employee contributions) allocated to participants in a defined contribution plan as required in § 415 (even if the excess did not result from the allocation of forfeitures or from a reasonable error in estimating compensation) is to place the excess annual additions into an unallocated account, similar to the suspense account described in § 1.415–6(b)(6)(iii), to be used as an employer contribution in the succeeding year(s). While such amounts remain in the unallocated account, the employer is not permitted to make additional contributions to the plan. The permitted VCS correction for failure to limit annual additions that are elective deferrals or employee contributions (even if the excess did not result from a reasonable error in determining the amount of elective deferrals or employee contributions that could be made with respect to an individual under the § 415 limits) is to distribute the elective deferrals or employee contributions

using a method similar to that described under § 1.415–6(b)(6)(iv). Elective deferrals and employee contributions that are matched may be returned, provided that the matching contributions relating to such contributions are forfeited (which will also reduce excess annual additions for the affected individuals). The forfeited matching contributions are to be placed into an unallocated account to be used as an employer contribution in succeeding periods.

APPENDIX B

CORRECTION METHODS AND EXAMPLES; EARNINGS ADJUSTMENT METHODS AND EXAMPLES

SECTION 1. PURPOSE, ASSUMPTIONS FOR EXAMPLES AND SECTION REFERENCES

.01 *Purpose*. (1) This appendix sets forth correction methods relating to Operational Failures under Qualified Plans. This appendix also sets forth earnings adjustment methods. The correction methods and earnings adjustment methods described in this appendix are acceptable under SCP and VCP (including VCS, but not VCT).

(2) This appendix does not apply to 403(b) Plans or SEPs. Accordingly, sponsors of 403(b) Plans or SEPs cannot rely on the correction methods and the earnings adjustment methods under this appendix.

.02 *Assumptions for Examples*. Unless otherwise specified, for ease of presentation, the examples assume that:

(1) the plan year and the § 415 limitation year are the calendar year;

(2) the employer maintains a single plan intended to satisfy § 401(a) and has never maintained any other plan;

(3) in a defined contribution plan, the plan provides that forfeitures are used to reduce future employer contributions;

(4) the Qualification Failures are Operational Failures and the eligibility and other requirements for SCP, VCP or Audit CAP, whichever applies, are satisfied; and

(5) there are no Qualification Failures other than the described Operational Failures, and if a corrective action would result in any additional Qualification Failure, appropriate corrective action is taken for that additional Qualification Failure in accordance with EPCRS.

.03 *Section References*. References to section 2 and section 3 are references to the section 2 and 3 in this appendix.

SECTION 2. CORRECTION METHODS AND EXAMPLES

.01 *ADP/ACP Failures*.

(1) *Correction Methods*. (a) VCS Correction Method. Appendix A, section .03 sets forth the VCS correction method for a failure to satisfy the actual deferral percentage ("ADP"), actual contribution percentage ("ACP"), or multiple use test set forth in §§ 401(k)(3), 401(m)(2), and 401(m)(9), respectively.

(b) One-to-One Correction Method. (i) General. In addition to the VCS correction method, a failure to satisfy the ADP, ACP, or multiple use test may be corrected using the one-to-one correction method set forth in this section 2.01(1)(b). Under the one-to-one correction method, an excess contribution amount is determined and assigned to highly compensated employees as provided in paragraph (1)(b)(ii) below. That excess contribution amount (adjusted for earnings) is either distributed to the highly compensated employees or forfeited from the highly compensated employees' accounts as provided in paragraph (1)(b)(iii) below. That same dollar amount (*i.e.*, the excess contribution amount, adjusted for earnings) is contributed to the plan and allocated to nonhighly compensated employees as provided in paragraph (1)(b)(iv) below. Under this correction method, a plan may not be treated as two separate plans, one covering otherwise excludable employees and the other covering all other employees (as permitted in § 1.410(b)–6(b)(3)). Likewise, restructuring the plan into component plans under § 1.401(k)–1(h)(3)(iii) is not permitted.

(ii) Determination of the Excess Contribution Amount. The excess contribution amount for the year is equal to the excess of (A) the sum of the excess contributions (as defined in § 401(k)(8)(B)), the excess aggregate contributions (as defined in § 401(m)(6)(B)), and the amount treated as excess contributions or excess aggregate contributions under the multiple use test pursuant to § 401(m)(9) and § 1.401(m)–2(c) for the year, as assigned to each highly compensated employee in accordance with § 401(k)(8)(C) and (m)(6)(C), over (B) previous corrections that complied with § 401(k)(8), (m)(6), and (m)(9). See Notice 97–2, 1997–1 C.B. 348.

(iii) Distributions and Forfeitures of the Excess Contribution Amount. (A) The portion of the excess contribution amount assigned to a particular highly compensated employee under paragraph (1)(b)(ii) is adjusted for earnings through the date of correction. The amount assigned to a particular highly compensated employee, as adjusted, is distributed or, to the extent the amount was forfeitable as of the close of the plan year of the failure, is forfeited. If the amount is forfeited, it is used in accordance with the plan provisions relating to forfeitures that were in effect for the year of the failure. If the amount so assigned to a particular highly compensated employee has been previously distributed; the amount is an Excess Amount within the meaning of section 5.01(3) of this revenue procedure. Thus, pursuant to section 6.05 of this revenue procedure, the employer must notify the employee that the Excess Amount was not eligible for favorable tax treatment accorded to distributions from qualified plans (and, specifically, was not eligible for tax-free rollover).

(B) If any matching contributions (adjusted for earnings) are forfeited in accordance with § 411(a)(3)(G), the forfeited amount is used in accordance with the plan provisions relating to forfeitures that were in effect for the year of the failure.

(C) If a payment was made to an employee and that payment is a forfeitable match described in either paragraph (1)(b)(iii)(A) or (B), then it is an Overpayment defined in section 5.01(6) of this revenue procedure that must be corrected (see sections 2.04 and 2.05 below).

(iv) Contribution and Allocation of Equivalent Amount. (A) The employer makes a contribution to the plan that is equal to the aggregate amounts distributed and forfeited under paragraph (1)(b)(iii)(A) (*i.e.*, the excess contribution amount adjusted for earnings, as provided in paragraph (1)(b)(iii)(A), which does not include any matching contributions forfeited in accordance with § 411(a)

(3)(G) as provided in paragraph (1)(b)(iii)(B)). The contribution must satisfy the vesting requirements and distribution limitations of § 401(k)(2)(B) and (C).

(B)(*1*) This paragraph (1)(b)(iv)(B)(*1*) applies to a plan that uses the current year testing method described in Notice 98–1, 1998–1 C.B. 327. The contribution made under paragraph (1)(b)(iv)(A) is allocated to the account balances of those individuals who were either (I) the eligible employees for the year of the failure who were not highly compensated employees for that year or (II) the eligible employees for the year of the failure who were not highly compensated employees for that year and who also are not highly compensated employees for the year of correction. Alternatively, the contribution is allocated to account balances of eligible employees described in (I) or (II) of the preceding sentence, except that the allocation is made only to the account balances of those employees who are employees on a date during the year of the correction that is no later than the date of correction. Regardless of which of these four options (described in the two preceding sentences) the employer selects, the contribution is allocated to each such employee either as the same percentage of the employee's compensation for the year of the failure or as the same dollar amount for each employee. (See Examples 1, 2 and 3.) Under the one-to-one correction method, the amount allocated to the account balance of an employee (*i.e*, the employee's share of the total amount contributed under paragraph (1)(b)(iv)(A)) is not further adjusted for earnings and is treated as an annual addition under § 415 for the year of the failure for the employee for whom it is allocated.

(*2*) This paragraph (1)(b)(iv)(B)(*2*) applies to a plan that uses the prior year testing method described in Notice 98–1. Paragraph (1)(b)(iv)(B)(*1*) is applied by substituting "the year prior to the year of the failure" for "the year of the failure".

(2) *Examples*.

Example 1:

Employer A maintains a profit-sharing plan with a cash or deferred arrangement that is intended to satisfy § 401(k) ("401(k) plan") using the current year testing method described in Notice 98–1. The plan does not provide for matching contributions or employee after-tax contributions. In 1999, it was discovered that the ADP test for 1997 was not performed correctly. When the ADP test was performed correctly, the test was not satisfied for 1997. For 1997, the ADP for highly compensated employees was 9% and the ADP for nonhighly compensated employees was 4%. Accordingly, the ADP for highly compensated employees exceeded the ADP for nonhighly compensated employees by more than two percentage points (in violation of § 401(k)(3)). (The ADP for nonhighly compensated employees for 1996 also was 4%, so the ADP test for 1997 would not have been satisfied even if the plan had used the prior year testing method described in Notice 98–1.) There were two highly compensated employees eligible under the 401(k) plan during 1997, Employee P and Employee Q. Employee P made elective deferrals of $8,000, which is equal to 10% of Employee P's compensation of $80,000 for 1997. Employee Q made elective deferrals of $9,500, which is equal to 8% of Employee Q's compensation of $118,750 for 1997.

Correction:

On June 30, 1999, Employer A uses the one-to-one correction method to correct the failure to satisfy the ADP test for 1997. Accordingly, Employer A calculates the dollar amount of the excess contributions for the two highly compensated employees in the manner described in § 401(k)(8)(B). The amount of the excess contribution for Employee P is $3,200 (4% of $80,000) and the amount of the excess contribution for Employee Q is $2,375 (2% of $118,750), or a total of $5,575. In accordance with § 401(k)(8)(C), $5,575, the excess contribution amount, is assigned $2,037.50 to Employee P and $3,537.50 to Employee Q. It is determined that the earnings on the assigned amounts through June 30, 1999, are $407 and $707 for Employees P and Q, respectively. The assigned amounts and the earnings are distributed to Employees P and Q. Therefore, Employee P receives $2,444.50 ($2,037.50 + $407) and Employee Q receives $4,244.50 ($3,537.50 + $707). In addition, on the same date, a corrective contribution is made to the 401(k) plan equal to $6,689 (the sum of the $2,444.50 distributed to Employee P and the $4,244.50 distributed to Employee Q). The corrective contribution is allocated to the account balances of eligible nonhighly compensated employees for 1997, *pro rata* based on their compensation for 1997 (subject to § 415 for 1997).

Example 2:

The facts are the same as in Example 1.

Correction:

The correction is the same as in Example 1, except that the corrective contribution of $6,689 is allocated in an equal dollar amount to the account balances of eligible nonhighly compensated employees for 1997 who are employees on June 30, 1999, and who are nonhighly compensated employees for 1999 (subject to § 415 for 1997).

Example 3:

The facts are the same as in Example 1, except that for 1997 the plan also provides (1) for employee after-tax contributions and (2) for matching contributions equal to 50% of the sum of an employee's elective deferrals and employee after-tax contributions that do not exceed 10% of the employee's compensation. The plan provides that matching contributions are subject to the plan's 5-year graded vesting schedule and that matching contributions are forfeited and used to reduce employer contributions if associated elective deferrals or employee after-tax contributions are distributed to correct an ADP, ACP or multiple use test failure. For 1997, nonhighly compensated employees made employee after-tax contributions and no highly compensated employee made any employee after-tax contributions. Employee P received a matching contribution of $4,000 (50% of $8,000) and Employee Q received a matching contribution of $4,750 (50% of $9,500). Employees P and Q were 100% vested in 1997. It is determined that, for 1997, the ACP for highly compensated employees was not more than 125% of the ACP for nonhighly compensated employees, so that the ACP and multiple use tests would have been satisfied for 1997 without any corrective action.

Correction:

The same corrective actions are taken as in Example 1. In addition, in accordance with the plan's terms, corrective action is taken to forfeit Employee P's and Employee Q's matching contributions associated with their distributed excess contributions. Employee P's distributed excess contributions and associated matching contributions are $2,037.50 and $1,018.75, respectively. Employee Q's distributed excess contributions and associated matching contributions are $3,537.50 and $1,768.75, respectively. Thus, $1,018.75 is forfeited from Employee P's account and $1,768.75 is forfeited from Employee Q's account. In addition, the earnings on the forfeited amounts are also forfeited. It is determined that the respective earnings on the forfeited amount for Employee P is $150 and for Employee Q is $204. The total amount of the forfeitures of $3,141.50 (Employee P's $1,018.75 + $150 and Employee Q's $1,768.75 + $204) is used to reduce contributions for 1999 and subsequent years.

.02 *Exclusion of Eligible Employees*.

(1) Exclusion of Eligible Employees in a 401(k) or (m) Plan. (a) Correction Method. (i) VCS Correction Method for Full Year Exclusion. Appendix A, section .05 sets forth the VCS correction method for the exclusion of an eligible employee from all contributions under a 401(k) or (m) plan for one or more full plan years. (See Example 4.) In section 2.02(1)(a)(ii)

below, the VCS correction method for the exclusion of an eligible employee from all contributions under a 401(k) or (m) plan for a full year is expanded to include correction for the exclusion of an eligible employee from all contributions under a 401(k) or (m) plan for a partial plan year. This correction for a partial year exclusion may be used in conjunction with the correction for a full year exclusion.

(ii) Expansion of VCS Correction Method to Partial Year Exclusion. (A) In General. The correction method in Appendix A, section .05 is expanded to cover an employee who was improperly excluded from making elective deferrals or employee after-tax contributions for a portion of a plan year or from receiving matching contributions (on either elective deferrals or employee after-tax contributions) for a portion of a plan year. In such case, a permitted correction method for the failure is for the employer to satisfy this section 2.02(1)(a)(ii). The employer makes a corrective contribution on behalf of the excluded employee that satisfies the vesting requirements and distribution limitations of § 401(k)(2)(B) and (C).

(B) Elective Deferral Failures. The appropriate corrective contribution for the failure to allow employees to make elective deferrals for a portion of the plan year is equal to the ADP of the employee's group (either highly or nonhighly compensated), determined prior to correction under this section 2.02(1)(a)(ii), multiplied by the employee's plan compensation for the portion of the year during which the employee was improperly excluded. The corrective contribution for the portion of the plan year during which the employee was improperly excluded from being eligible to make elective deferrals is reduced to the extent that (*1*) the sum of that contribution and any elective deferrals actually made by the employee for that year would exceed (*2*) the maximum elective deferrals permitted under the plan for the employee for that plan year (including the § 402(g) limit). The corrective contribution is adjusted for earnings. (See Examples 5 and 6.)

(C) Employee After-tax and Matching Contribution Failures. The appropriate corrective contribution for the failure to allow employees to make employee after-tax contributions or to receive matching contributions because the employee was precluded from making employee after-tax contributions or elective deferrals for a portion of the plan year is equal to the ACP of the employee's group (either highly or nonhighly compensated), determined prior to correction under this section 2.02(1)(a)(ii), multiplied by the employee's plan compensation for the portion of the year during which the employee was improperly excluded. The corrective contribution is reduced to the extent that (*1*) the sum of that contribution and the actual total employee after-tax and matching contributions made by and for the employee for the plan year would exceed (*2*) the sum of the maximum employee after-tax contributions permitted under the plan for the employee for the plan year and the matching contributions that would have been made if the employee had made the maximum matchable contributions permitted under the plan for the employee for that plan year. The corrective contribution is adjusted for earnings.

(D) Use of Prorated Compensation. For purposes of this paragraph (1)(a)(ii), for administrative convenience, in lieu of using the employee's actual plan compensation for the portion of the year during which the employee was improperly excluded, a *pro rata* portion of the employee's plan compensation that would have been taken into account for the plan year, if the employee had not been improperly excluded, may be used.

(E) Special Rule for Brief Exclusion from Elective Deferrals. An employer is not required to make a corrective contribution with respect to elective deferrals, as provided in section 2.02(1)(a)(ii)(B), (but is required to make a corrective contribution with respect to any employee after-tax and matching contributions, as provided in section 2.02(1)(a)(ii)(C)) for an employee for a plan year if the employee has been provided the opportunity to make elective deferrals under the plan for a period of at least the last 9 months in that plan year and during that period the employee had the opportunity to make elective deferrals in an amount not less than the maximum amount that would have been permitted if no failure had occurred. (See Example 7.)

(b) Examples.

Example 4:

Employer B maintains a 401(k) plan. The plan provides for matching contributions for eligible employees equal to 100% of elective deferrals that do not exceed 3% of an employee's compensation. The plan provides that employees who complete one year of service are eligible to participate in the plan on the next January 1 or July 1 entry date. Twelve employees (8 nonhighly compensated employees and 4 highly compensated employees) who had met the one year eligibility requirement after July 1, 1995, and before January 1, 1996, were inadvertently excluded from participating in the plan beginning on January 1, 1996. These employees were offered the opportunity to begin participating in the plan on January 1, 1997. For 1996, the ADP for the highly compensated employees was 8% and the ADP for the nonhighly compensated employees was 6% . In addition, for 1996, the ACP for the highly compensated employees was 2.5% and the ACP for the nonhighly compensated employees was 2% . The failure to include the 12 employees was discovered during 1998.

Correction:

Employer B uses the VCS correction method for full year exclusions to correct the failure to include the 12 eligible employees in the plan for the full plan year beginning January 1, 1996. Thus, Employer B makes a corrective contribution (that satisfies the vesting requirements and distribution limitations of § 401(k)(2)(B) and (C)) for each of the excluded employees. The contribution for each of the improperly excluded highly compensated employees is 10.5% (the highly compensated employees' ADP of 8% plus ACP of 2.5%) of the employee's plan compensation for the 1996 plan year (adjusted for earnings). The contribution for each of the improperly excluded nonhighly compensated employees is 8% (the nonhighly compensated employees' ADP of 6% plus ACP of 2%) of the employee's plan compensation for the 1996 plan year (adjusted for earnings).

Example 5:

Employer C maintains a 401(k) plan. The plan provides for matching contributions for each payroll period that are equal to 100% of an employee's elective deferrals that do not exceed 2% of the eligible employee's plan compensation during the payroll period. The plan does not provide for employee after-tax contributions. The plan provides that employees who complete one year of service are eligible to participate in the plan on the next January 1 or July 1 entry date. A nonhighly compensated employee who met the eligibility requirements and should have entered the plan on January 1, 1996, was not offered the opportunity to participate in the plan. In August of 1996, the error was discovered and Employer C offered the employee an election opportunity as of September 1, 1996. The employee made elective deferrals equal to 4% of the employee's plan compensation for each payroll period from September 1, 1996, through

December 31, 1996 (resulting in elective deferrals of $500). The employee's plan compensation for 1996 was $36,000 ($23,500 for the first eight months and $12,500 for the last four months). Employer C made matching contributions equal to $250 for the excluded employee, which is 2% of the employee's plan compensation for each payroll period from September 1, 1996, through December 31, 1996 ($12,500). The ADP for nonhighly compensated employees for 1996 was 3% and the ACP for nonhighly compensated employees for 1996 was 1.8% .

Correction:

Employer C uses the VCS correction method for partial year exclusions to correct the failure to include the eligible employee in the plan. Thus, Employer C makes a corrective contribution (that satisfies the vesting requirements and distribution limitations of § 401(k)(2)(B) and (C)) for the excluded employee. In determining the amount of corrective contributions (both for the elective deferral and for the matching contribution), for administrative convenience, in lieu of using actual plan compensation of $23,500 for the period the employee was excluded, the employee's annual plan compensation is pro rated for the eight-month period that the employee was excluded from participating in the plan. The failure to provide the excluded employee the right to make elective deferrals is corrected by the employer making a corrective contribution on behalf of the employee that is equal to $720 (the 3% ADP percentage for nonhighly compensated employees multiplied by $24,000, which is 8/12ths of the employee's 1996 plan compensation of $36,000), adjusted for earnings. In addition, to correct for the failure to receive the plan's matching contribution, a corrective contribution is made on behalf of the employee that is equal to $432 (the 1.8% ACP for the nonhighly compensated group multiplied by $24,000, which is 8/12ths of the employee's 1996 plan compensation of $36,000), adjusted for earnings. Employer C determines that $682, the sum of the actual matching contribution received by the employee for the plan year ($250) and the corrective contribution to correct the matching contribution failure ($432), does not exceed $720, the maximum matching contribution available to the employee under the plan (2% of $36,000) determined as if the employee had made the maximum matchable contributions. In addition to correcting the failure to include the eligible employee in the plan, Employer C reruns the ADP and ACP tests for 1996 (taking into account the corrective contribution and plan compensation for 1996 for the excluded employee) and determines that the tests were satisfied.

Example 6:

The facts are the same as in Example 5, except that the plan provides for matching contributions that are equal to 100% of an eligible employee's elective deferrals that do not exceed 2% of the employee's plan compensation for the plan year. Accordingly, the actual matching contribution made by Employer C for the excluded employee for the last four months of 1996 is $500 (which is equal to 100% of the $500 of elective deferrals made by the employee for the last four months of 1996).

Correction:

The correction is the same as in Example 5, except that the corrective contribution made for the first 8 months of 1996 to correct the failure to make matching contributions is equal to $220 (adjusted for earnings), instead of the $432 (adjusted for earnings) in Example 5, because the corrective contribution is limited to the maximum matching contributions available under the plan for the employee for the plan year, $720 (2% of $36,000), reduced by the actual matching contributions made for the employee for the plan year, $500.

Example 7:

The facts are the same as in Example 5, except that the error is discovered in March of 1996 and the employee was given the opportunity to make elective deferrals beginning on April 1, 1996. The amount of elective deferrals that the employee was given the opportunity to make during 1996 was not less than the maximum elective deferrals that the employee could have made if the employee had been given the opportunity to make elective deferrals beginning on January 1, 1996. The employee made elective deferrals equal to 4% of the employee's plan compensation for each payroll period from April 1, 1996, through December 31, 1996, of $28,000 (resulting in elective deferrals of $1,120). Employer C made a matching contribution equal to $560, which is 2% of the employee's plan compensation for each payroll period from April 1, 1996, through December 31, 1996 ($28,000). The employee's plan compensation for 1996 was $36,000 ($8,000 for the first three months and $28,000 for the last nine months).

Correction:

Employer C uses the VCS correction method for partial year exclusions to correct the failure to include an eligible employee in the plan. Because the employee was given an opportunity to make elective deferrals to the plan for at least the last 9 months of the plan year (and the amount of the elective deferrals that the employee had the opportunity to make was not less than the maximum elective deferrals that the employee could have made if the employee had been given the opportunity to make elective deferrals beginning on January 1, 1996), under the special rule set forth in section 2.02(1)(a)(ii)(E), Employer C is not required to make a corrective contribution for the failure to allow the employee to make elective deferrals. In determining the amount of corrective contribution with respect to the failure to allow the employee to receive matching contributions, in lieu of using actual plan compensation of $8,000 for the period the employee was excluded, the employee's annual plan compensation is pro rated for the three-month period that the employee was excluded from participating in the plan. Accordingly, a corrective contribution is made on behalf of the employee that is equal to $160, which is the lesser of (i) $162 (a matching contribution of 1.8% of $9,000, which is 3/12ths of the employee's 1996 plan compensation of $36,000), and (ii) $160 (the excess of the maximum matching contribution for the entire plan year, which is equal to 2% of $36,000, or $720, over the matching contributions made after March 31, 1996, $560). The contribution is adjusted for earnings.

(2) Exclusion of Eligible Employees In a Profit-Sharing Plan.

(a) Correction Methods. (i) VCS Correction Method. Appendix A, section .05 sets forth the VCS correction method for correcting the exclusion of an eligible employee. In the case of a defined contribution plan, the VCS correction method is to make a contribution on behalf of the excluded employee. Section 2.02(2)(a)(ii) below clarifies the VCS correction method in the case of a profit-sharing or stock bonus plan that provides for nonelective contributions (within the meaning of § 1.401(k)–1(g)(10)).

(ii) Clarification of VCS Correction Method for Profit-Sharing Plans. To correct for the exclusion of an eligible employee from nonelective contributions in a profit-sharing or stock bonus plan under the VCS correction method, an allocation amount is determined for each excluded employee on the same basis as the allocation amounts were determined for the other employees under the plan's allocation formula (*e.g.*, the same ratio of allocation to compensation), taking into account all of the employee's relevant factors (*e.g.*, compensation) under that formula for that year. The employer makes a corrective contribution on behalf of the excluded employee that is equal to the allocation amount for the excluded employee. The corrective contribution is adjusted for earnings. If, as a result of excluding an employee, an amount was improperly allocated to the account balance of an eligible employee who shared in the original allocation of the nonelective contribution, no reduction is made to the account balance of the employee who shared in the original allocation on account of the improper allocation. (See Example 8.)

(iii) Reallocation Correction Method. (A) In General. Subject to the limitations set forth in section 2.02(2)(a)(iii)(F) below, in addition to the VCS correction method, the exclusion of an eligible employee for a plan year from

a profit-sharing or stock bonus plan that provides for nonelective contributions may be corrected using the reallocation correction method set forth in this section 2.02(2)(a)(iii). Under the reallocation correction method, the account balance of the excluded employee is increased as provided in paragraph (2)(a)(iii)(B) below, the account balances of other employees are reduced as provided in paragraph (2)(a)(iii)(C) below, and the increases and reductions are reconciled, as necessary, as provided in paragraph (2)(a)(iii)(D) below. (See Examples 9 and 10.)

(B) Increase in Account Balance of Excluded Employee. The account balance of the excluded employee is increased by an amount that is equal to the allocation the employee would have received had the employee shared in the allocation of the nonelective contribution. The amount is adjusted for earnings.

(C) Reduction in Account Balances of Other Employees. (*1*) The account balance of each employee who was an eligible employee who shared in the original allocation of the nonelective contribution is reduced by the excess, if any, of (I) the employee's allocation of that contribution over (II) the amount that would have been allocated to that employee had the failure not occurred. This amount is adjusted for earnings taking into account the rules set forth in section 2.02(2)(a)(iii)(C)(*2*) and (*3*) below. The amount after adjustment for earnings is limited in accordance with section 2.02(2)(a)(iii)(C)(*4*) below.

(*2*) This paragraph (2)(a)(iii)(C)(*2*) applies if most of the employees with account balances that are being reduced are nonhighly compensated employees. If there has been an overall gain for the period from the date of the original allocation of the contribution through the date of correction, no adjustment for earnings is required to the amount determined under section 2.02(2)(a)(iii)(C)(*1*) for the employee. If the amount for the employee is being adjusted for earnings and the plan permits investment of account balances in more than one investment fund, for administrative convenience, the reduction to the employee's account balance may be adjusted by the lowest earnings rate of any fund for the period from the date of the original allocation of the contribution through the date of correction.

(*3*) If an employee's account balance is reduced and the original allocation was made to more than one investment fund or there was a subsequent distribution or transfer from the fund receiving the original allocation, then reasonable, consistent assumptions are used to determine the earnings adjustment.

(*4*) The amount determined in section 2.02(2)(a)(iii)(C)(*1*) for an employee after the application of section 2.02(2)(a)(iii)(C)(*2*) and (*3*) may not exceed the account balance of the employee on the date of correction, and the employee is permitted to retain any distribution made prior to the date of correction.

(D) Reconciliation of Increases and Reductions. If the aggregate amount of the increases under section 2.02(2)(a)(iii)(B) exceeds the aggregate amount of the reductions under section 2.02(2)(a)(iii)(C), the employer makes a corrective contribution to the plan for the amount of the excess. If the aggregate amount of the reductions under section 2.02(2)(a)(iii)(C) exceeds the aggregate amount of the increases under section 2.02(2)(a)(iii)(B), then the amount by which each employee's account balance is reduced under section 2.02(2)(a)(iii)(C) is decreased on a *pro rata* basis.

(E) Reductions Among Multiple Investment Funds. If an employee's account balance is reduced and the employee's account balance is invested in more than one investment fund, then the reduction may be made from the investment funds selected in any reasonable manner.

(F) Limitations on Use of Reallocation Correction Method. If any employee would be permitted to retain any distribution pursuant to section 2.02(2)(a)(iii)(C)(*4*), then the reallocation correction method may not be used unless most of the employees who would be permitted to retain a distribution are nonhighly compensated employees.

(b) Examples.

Example 8:

Employer D maintains a profit-sharing plan that provides for discretionary nonelective employer contributions. The plan provides that the employer's contributions are allocated to account balances in the ratio that each eligible employee's compensation for the plan year bears to the compensation of all eligible employees for the plan year and, therefore, the only relevant factor for determining an allocation is the employee's compensation. The plan provides for self-directed investments among four investment funds and daily valuations of account balances. For the 1997 plan year, Employer D made a contribution to the plan of a fixed dollar amount. However, five employees who met the eligibility requirements were inadvertently excluded from participating in the plan. The contribution resulted in an allocation on behalf of each of the eligible employees, other than the excluded employees, equal to 10% of compensation. Most of the employees who received allocations under the plan for the year of the failure were nonhighly compensated employees. No distributions have been made from the plan since 1997. If the five excluded employees had shared in the original allocation, the allocation made on behalf of each employee would have equaled 9% of compensation. The excluded employees began participating in the plan in the 1998 plan year.

Correction:

Employer D uses the VCS correction method to correct the failure to include the five eligible employees. Thus, Employer D makes a corrective contribution to the plan. The amount of the corrective contribution on behalf of the five excluded employees for the 1997 plan year is equal to 10% of compensation of each excluded employee, the same allocation that was made for other eligible employees, adjusted for earnings. The excluded employees receive an allocation equal to 10% of compensation (adjusted for earnings) even though, had the excluded employees originally shared in the allocation for the 1997 contribution, their account balances, as well as those of the other eligible employees, would have received an allocation equal to only 9% of compensation.

Example 9:

The facts are the same as in Example 8.

Correction:

Employer D uses the reallocation correction method to correct the failure to include the five eligible employees. Thus, the account balances are adjusted to reflect what would have resulted from the correct allocation of the employer contribution for the 1997 plan year among all eligible employees, including the five excluded employees. The inclusion of the excluded employees in the allocation of that contribution would have resulted in each eligible employee, including each excluded employee, receiving an allocation equal to 9% of compensation. Accordingly, the account balance of each excluded employee is increased by 9% of the employee's 1997 compensation, adjusted for earnings. The account balance of each of the eligible employees other than the excluded employees is reduced by 1% of the employee's 1997 compensation, adjusted for earnings. Employer D determines the adjustment for earnings using the earnings rate of each eligible employee's excess

allocation (using reasonable, consistent assumptions). Accordingly, for an employee who shared in the original allocation and directed the investment of the allocation into more than one investment fund or who subsequently transferred a portion of a fund that had been credited with a portion of the 1997 allocation to another fund, reasonable, consistent assumptions are followed to determine the adjustment for earnings. It is determined that the total of the initially determined reductions in account balances exceeds the total of the required increases in account balances. Accordingly, these initially determined reductions are decreased *pro rata* so that the total of the actual reductions in account balances equals the total of the increases in the account balances, and Employer D does not make any corrective contribution. The reductions from the account balances are made on a *pro rata* basis among all of the funds in which each employee's account balance is invested.

Example 10:

The facts are the same as in Example 8.

Correction:

The correction is the same as in Example 9, except that, because most of the employees whose account balances are being reduced are nonhighly compensated employees, for administrative convenience, Employer D uses the earnings rate of the fund with the lowest earnings rate for the period of the failure to adjust the reduction to each account balance. It is determined that the aggregate amount (adjusted for earnings) by which the account balances of the excluded employees is increased exceeds the aggregate amount (adjusted for earnings) by which the other employees' account balances are reduced. Accordingly, Employer D makes a contribution to the plan in an amount equal to the excess. The reduction from account balances is made on a *pro rata* basis among all of the funds in which each employee's account balance is invested.

.03 *Vesting Failures.*

(1) Correction Methods. (a) Contribution Correction Method. A failure in a defined contribution plan to apply the proper vesting percentage to an employee's account balance that results in forfeiture of too large a portion of the employee's account balance may be corrected using the contribution correction method set forth in this paragraph. The employer makes a corrective contribution on behalf of the employee whose account balance was improperly forfeited in an amount equal to the improper forfeiture. The corrective contribution is adjusted for earnings. If, as a result of the improper forfeiture, an amount was improperly allocated to the account balance of another employee, no reduction is made to the account balance of that employee. (See Example 11.)

(b) Reallocation Correction Method. In addition to the contribution correction method, in a defined contribution plan under which forfeitures of account balances are reallocated among the account balances of the other eligible employees in the plan, a failure to apply the proper vesting percentage to an employee's account balance which results in forfeiture of too large a portion of the employee's account balance may be corrected under the reallocation correction method set forth in this paragraph. A corrective reallocation is made in accordance with the reallocation correction method set forth in section 2.02(2)(a)(iii), subject to the limitations set forth in section 2.02(2)(a)(iii)(F). In applying section 2.02(2)(a)(iii)(B), the account balance of the employee who incurred the improper forfeiture is increased by an amount equal to the amount of the improper forfeiture and the amount is adjusted for earnings. In applying section 2.02(2)(a)(iii)(C)(*1*), the account balance of each employee who shared in the allocation of the improper forfeiture is reduced by the amount of the improper forfeiture that was allocated to that employee's account. The earnings adjustments for the account balances that are being reduced are determined in accordance with sections 2.02(2)(a)(iii)(C)(*2*) and (*3*) and the reductions after adjustments for earnings are limited in accordance with section 2.02(2)(a)(iii)(C)(*4*). In accordance with section 2.02(2)(a)(iii)(D), if the aggregate amount of the increases exceeds the aggregate amount of the reductions, the employer makes a corrective contribution to the plan for the amount of the excess. In accordance with section 2.02(2)(a)(iii)(D), if the aggregate amount of the reductions exceeds the aggregate amount of the increases, then the amount by which each employee's account balance is reduced is decreased on a *pro rata* basis. (See Example 12.)

(2) Examples.

Example 11:

Employer E maintains a profit-sharing plan that provides for nonelective contributions. The plan provides for self-directed investments among four investment funds and daily valuation of account balances. The plan provides that forfeitures of account balances are reallocated among the account balances of other eligible employees on the basis of compensation. During the 1997 plan year, Employee R terminated employment with Employer E and elected and received a single-sum distribution of the vested portion of his account balance. No other distributions have been made since 1997. However, an incorrect determination of Employee R's vested percentage was made resulting in Employee R receiving a distribution of less than the amount to which he was entitled under the plan. The remaining portion of Employee R's account balance was forfeited and reallocated (and these reallocations were not affected by the limitations of § 415). Most of the employees who received allocations of the improper forfeiture were nonhighly compensated employees.

Correction:

Employer E uses the contribution correction method to correct the improper forfeiture. Thus, Employer E makes a contribution on behalf of Employee R equal to the incorrectly forfeited amount (adjusted for earnings) and Employee R's account balance is increased accordingly. No reduction is made from the account balances of the employees who received an allocation of the improper forfeiture.

Example 12:

The facts are the same as in Example 11.

Correction:

Employer E uses the reallocation correction method to correct the improper forfeiture. Thus, Employee R's account balance is increased by the amount that was improperly forfeited (adjusted for earnings). The account of each employee who shared in the allocation of the improper forfeiture is reduced by the amount of the improper forfeiture that was allocated to that employee's account (adjusted for earnings). Because most of the employees whose account balances are being reduced are nonhighly compensated employees, for administrative convenience, Employer E uses the earnings rate of the fund with the lowest earnings rate for the period of the failure to adjust the reduction to each account balance. It is determined that the amount (adjusted for earnings) by which the account balance of Employee R is increased exceeds the aggregate amount (adjusted for earnings) by which the other employees' account balances are reduced. Accordingly, Employer E makes a contribution to the plan in an amount equal to the excess. The reduction from the account balances is made on a *pro rata* basis among all of the funds in which each employee's account balance is invested.

.04 *§ 415 Failures.*

(1) Failures Relating to a § 415(b) Excess.

(a) Correction Methods. (i) Return of Overpayment Correction Method. Overpayments as a result of amounts being paid in excess of the limits of

§ 415(b) may be corrected using the return of Overpayment correction method set forth in this paragraph (1)(a)(i). The employer takes reasonable steps to have the Overpayment (with appropriate interest) returned by the recipient to the plan and reduces future benefit payments (if any) due to the employee to reflect § 415(b). To the extent the amount returned by the recipient is less than the Overpayment, adjusted for earnings at the plan's earnings rate, then the employer or another person contributes the difference to the plan. In addition, in accordance with section 6.05 of this revenue procedure, the employer must notify the recipient that the Overpayment was not eligible for favorable tax treatment accorded to distributions from qualified plans (and, specifically, was not eligible for tax-free rollover). (See Examples 15 and 16.)

(ii) Adjustment of Future Payments Correction Method. (A) In General. In addition to the return of overpayment correction method, in the case of plan benefits that are being distributed in the form of periodic payments, Overpayments as a result of amounts being paid in excess of the limits in § 415(b) may be corrected by using the adjustment of future payments correction method set forth in this paragraph (1)(a)(ii). Future payments to the recipient are reduced so that they do not exceed the § 415(b) maximum limit and an additional reduction is made to recoup the Overpayment (over a period not longer than the remaining payment period) so that the actuarial present value of the additional reduction is equal to the Overpayment plus interest at the interest rate used by the plan to determine actuarial equivalence. (See Examples 13 and 14.)

(B) Joint and Survivor Annuity Payments. If the employee is receiving payments in the form of a joint and survivor annuity, with the employee's spouse to receive a life annuity upon the employee's death equal to a percentage (*e.g.*, 75%) of the amount being paid to the employee, the reduction of future annuity payments to reflect § 415(b) reduces the amount of benefits payable during the lives of both the employee and spouse, but any reduction to recoup Overpayments made to the employee does not reduce the amount of the spouse's survivor benefit. Thus, the spouse's benefit will be based on the previous specified percentage (*e.g.*, 75%) of the maximum permitted under § 415(b), instead of the reduced annual periodic amount payable to the employee.

(C) Overpayment Not Treated as an Excess Amount. An Overpayment corrected under this adjustment of future payment correction method is not treated as an Excess Amount as defined in section 5.01(3) of this revenue procedure.

(b) Examples.

Example 13:

Employer F maintains a defined benefit plan funded solely through employer contributions. The plan provides that the benefits of employees are limited to the maximum amount permitted under § 415(b), disregarding cost-of-living adjustments under § 415(d) after benefit payments have commenced. At the beginning of the 1998 plan year, Employee S retired and started receiving an annual straight life annuity of $140,000 from the plan. Due to an administrative error, the annual amount received by Employee S for 1998 included an Overpayment of $10,000 (because the § 415(b)(1)(A) limit for 1998 was $130,000). This error was discovered at the beginning of 1999.

Correction:

Employer F uses the adjustment of future payments correction method to correct the failure to satisfy the limit in § 415(b). Future annuity benefit payments to Employee S are reduced so that they do not exceed the § 415(b) maximum limit, and, in addition, Employee S's future benefit payments from the plan are actuarially reduced to recoup the Overpayment. Accordingly, Employee S's future benefit payments from the plan are reduced to $130,000 and further reduced by $1,000 annually for life, beginning in 1999. The annual benefit amount is reduced by $1,000 annually for life because, for Employee S, the actuarial present value of a benefit of $1,000 annually for life commencing in 1999 is equal to the sum of $10,000 and interest at the rate used by the plan to determine actuarial equivalence beginning with the date of the first Overpayment and ending with the date the reduced annuity payment begins. Thus, Employee S's remaining benefit payments are reduced so that Employee S receives $129,000 for 1999, and for each year thereafter.

Example 14:

The facts are the same as in Example 13.

Correction:

Employer F uses the adjustments of future payments correction method to correct the § 415(b) failure, by recouping the entire excess payment made in 1998 from Employee S's remaining benefit payments for 1999. Thus, Employee S's annual annuity benefit for 1999 is reduced to $119,400 to reflect the excess benefit amounts (increased by interest) that were paid from the plan to Employee S during the 1998 plan year. Beginning in 2000, Employee S begins to receive annual benefit payments of $130,000.

Example 15:

The facts are the same as in Example 13, except that the benefit was paid to Employee S in the form of a single-sum distribution in 1998, which exceeded the maximum § 415(b) limits by $110,000.

Correction:

Employer F uses the return of overpayment correction method to correct the § 415(b) failure. Thus, Employer F notifies Employee S of the $110,000 Overpayment and that the Overpayment was not eligible for favorable tax treatment accorded to distributions from qualified plans (and, specifically, was not eligible for tax-free rollover). The notice also informs Employee S that the Overpayment (with interest at the rate used by the plan to calculate the single-sum payment) is owed to the plan. Employer F takes reasonable steps to have the Overpayment (with interest at the rate used by the plan to calculate the single-sum payment) paid to the plan. Employee S pays the $110,000 (plus the requested interest) to the plan. It is determined that the plan's earnings rate for the relevant period was 2 percentage points more than the rate used by the plan to calculate the single-sum payment. Accordingly, Employer F contributes the difference to the plan.

Example 16:

The facts are the same as in Example 15.

Correction:

Employer F uses the return of overpayment correction method to correct the § 415(b) failure. Thus, Employer F notifies Employee S of the $110,000 Overpayment and that the Overpayment was not eligible for favorable tax treatment accorded to distributions from qualified plans (and, specifically, was not eligible for tax-free rollover). The notice also informs Employee S that the Overpayment (with interest at the rate used by the plan to calculate the single-sum payment) is owed to the plan. Employer F takes reasonable steps to have the Overpayment (with interest at the rate used by the plan to calculate the single-sum payment) paid to the plan. As a result of Employer F's recovery efforts, some, but not all, of the Overpayment (with interest) is recovered from Employee S. It is determined that the amount returned by Employee S to the plan is less than the Overpayment adjusted for earnings at the plan's earnings rate. Accordingly, Employer F contributes the difference to the plan.

(2) Failures Relating to a § 415(c) Excess.

(a) Correction Methods. (i) VCS Correction Method. Appendix A, section .08 sets forth the VCS correction method for correcting the failure to satisfy the § 415(c) limits on annual additions.

(ii) Forfeiture Correction Method. In addition to the VCS correction method, the failure to satisfy § 415(c) with respect to a nonhighly compensated employee (A) who in the limitation year of the failure had annual additions consisting of both (I) either elective deferrals or employee after-tax contributions or both and (II) either matching or nonelective contributions or both, (B) for whom the matching and nonelective contributions equal or exceed the portion of the employee's annual addition that exceeds the limits under § 415(c) ("§ 415(c) excess") for the limitation year, and (C) who has terminated with no vested interest in the matching and nonelective contributions (and has not been reemployed at the time of the correction), may be corrected by using the forfeiture correction method set forth in this paragraph. The § 415(c) excess is deemed to consist solely of the matching and nonelective contributions. If the employee's § 415(c) excess (adjusted for earnings) has previously been forfeited, the § 415(c) failure is deemed to be corrected. If the § 415(c) excess (adjusted for earnings) has not been forfeited, that amount is placed in an unallocated account, similar to the suspense account described in § 1.415–6(b)(6)(iii), to be used to reduce employer contributions in succeeding year(s) (or if the amount would have been allocated to other employees who were in the plan for the year of the failure if the failure had not occurred, then that amount is reallocated to the other employees in accordance with the plan's allocation formula). Note that while this correction method will permit more favorable tax treatment of elective deferrals for the employee than the VCS correction method, this correction method could be less favorable to the employee in certain cases, for example, if the employee is subsequently reemployed and becomes vested. (See Examples 17 and 18.)

(iii) Return of Overpayment Correction Method. A failure to satisfy § 415(c) that includes a distribution of the § 415(c) excess attributable to nonelective contributions and matching contributions may be corrected using the return of overpayment correction method set forth in this paragraph. The employer takes reasonable steps to have the Overpayment (*i.e.*, the distribution of the § 415(c) excess adjusted for earnings to the date of the distribution), plus appropriate interest from the date of the distribution to the date of the repayment, returned by the employee to the plan. To the extent the amount returned by the employee is less than the Overpayment adjusted for earnings at the plan's earnings rate, then the employer or another person contributes the difference to the plan. The Overpayment, adjusted for earnings at the plan's earnings rate to the date of the repayment, is to be placed in an unallocated account, similar to the suspense account described in § 1.415–6(b)(6)(iii), to be used to reduce employer contributions in succeeding year(s) (or if the amount would have been allocated to other eligible employees who were in the plan for the year of the failure if the failure had not occurred, then that amount is reallocated to the other eligible employees in accordance with the plan's allocation formula). In addition, the employer must notify the employee that the Overpayment was not eligible for favorable tax treatment accorded to distributions from qualified plans (and, specifically, was not eligible for tax-free rollover).

(b) Examples.

Example 17:

Employer G maintains a 401(k) plan. The plan provides for nonelective employer contributions, elective deferrals, and employee after-tax contributions. The plan provides that the nonelective contributions vest under a 5-year cliff vesting schedule. The plan provides that when an employee terminates employment, the employee's nonvested account balance is forfeited five years after a distribution of the employee's vested account balance and that forfeitures are used to reduce employer contributions. For the 1998 limitation year, the annual additions made on behalf of two nonhighly compensated employees in the plan, Employees T and U, exceeded the limit in § 415(c). For the 1998 limitation year, Employee T had § 415 compensation of $60,000, and, accordingly, a § 415(c)(1)(B) limit of $15,000. Employee T made elective deferrals and employee after-tax contributions. For the 1998 limitation year, Employee U had § 415 compensation of $40,000, and, accordingly, a § 415(c)(1)(B) limit of $10,000. Employee U made elective deferrals. Also, on January 1, 1999, Employee U, who had three years of service with Employer G, terminated his employment and received his entire vested account balance (which consisted of his elective deferrals). The annual additions for Employees T and U consisted of:

	T	U
Nonelective Contributions	$7,500	$4,500
Elective Deferrals	10,000	5,800
After-tax Contributions	500	0
Total Contributions	$18,000	$10,300
§ 415(c) Limit	$15,000	$10,000
§ 415(c) Excess	$3,000	$300

Correction:

Employer G uses the VCS correction method to correct the § 415(c) excess with respect to Employee T (*i.e.*, $3,000). Thus, a distribution of plan assets (and corresponding reduction of the account balance) consisting of $500 (adjusted for earnings) of employee after-tax contributions and $2,500 (adjusted for earnings) of elective deferrals is made to Employee T. Employer G uses the forfeiture correction method to correct the § 415(c) excess with

respect to Employee U. Thus, the § 415(c) excess is deemed to consist solely of the nonelective contributions. Accordingly, Employee U's nonvested account balance is reduced by $300 (adjusted for earnings) which is placed in an unallocated account, similar to the suspense account described in § 1.415–6(b)(6)(iii), to be used to reduce employer contributions in succeeding year(s). After correction, it is determined that the ADP and ACP tests for 1998 were satisfied.

Example 18:

Employer H maintains a 401(k) plan. The plan provides for nonelective employer contributions, matching contributions and elective deferrals. The plan provides for matching contributions that are equal to 100% of an employee's elective deferrals that do not exceed 8% of the employee's plan compensation for the plan year. For the 1998 limitation year, Employee V had § 415 compensation of $50,000, and, accordingly, a § 415(c)(1)(B) limit of $12,500. During that limitation year, the annual additions for Employee V totaled $15,000, consisting of $5,000 in elective deferrals, a $4,000 matching contribution (8% of $50,000), and a $6,000 nonelective employer contribution. Thus, the annual additions for Employee V exceeded the § 415(c) limit by $2,500.

Correction:

Employer H uses the VCS correction method to correct the § 415(c) excess with respect to Employee V (*i.e.*, $2,500). Accordingly, $1,000 of the unmatched elective deferrals (adjusted for earnings) are distributed to Employee V. The remaining $1,500 excess is apportioned equally between the elective deferrals and the associated matching employer contributions, so Employee V's account balance is further reduced by distributing to Employee V $750 (adjusted for earnings) of the elective deferrals and forfeiting $750 (adjusted for earnings) of the associated employer matching contributions. The forfeited matching contributions are placed in an unallocated account; similar to the suspense account described in § 1.415–6(b)(6)(iii), to be used to reduce employer contributions in succeeding year(s). After correction, it is determined that the ADP and ACP tests for 1998 were satisfied.

.05 *Correction of Other Overpayment Failures.*

An Overpayment, other than one described in section 2.04(1) (relating to a § 415(b) excess) or section 2.04(2) (relating to a § 415(c) excess), may be corrected in accordance with this section 2.05. An Overpayment from a defined benefit plan is corrected in accordance with the rules in section 2.04(1). An Overpayment from a defined contribution plan is corrected in accordance with the rules in section 2.04(2)(a)(iii).

.06 *§ 401(a)(17) Failures.*

(1) Reduction of Account Balance Correction Method. The allocation of contributions or forfeitures under a defined contribution plan for a plan year on the basis of compensation in excess of the limit under § 401(a)(17) for the plan year may be corrected using the reduction of account balance correction method set forth in this paragraph. The account balance of an employee who received an allocation on the basis of compensation in excess of the § 401(a)(17) limit is reduced by this improperly allocated amount (adjusted for earnings). If the improperly allocated amount would have been allocated to other employees in the year of the failure if the failure had not occurred, then that amount (adjusted for earnings) is reallocated to those employees in accordance with the plan's allocation formula. If the improperly allocated amount would not have been allocated to other employees absent the failure, that amount (adjusted for earnings) is placed in an unallocated account, similar to the suspense account described in § 1.415–6(b)(6)(iii), to be used to reduce employer contributions in succeeding year(s). For example, if a plan provides for a fixed level of employer contributions for each eligible employee, and the plan provides that forfeitures are used to reduce future employer contributions, the improperly allocated amount (adjusted for earnings) would be used to reduce future employer contributions. (See Example 19.) If a payment was made to an employee and that payment was attributable to an improperly allocated amount, then it is an Overpayment defined in section 5.01(6) of this revenue procedure that must be corrected (see sections 2.04 and 2.05).

(2) Example.

Example 19:

Employer J maintains a money purchase pension plan. Under the plan, an eligible employee is entitled to an employer contribution of 8% of the employee's compensation up to the § 401(a)(17) limit ($160,000 for 1998). During the 1998 plan year, an eligible employee, Employee W, inadvertently was credited with a contribution based on compensation above the § 401(a)(17) limit. Employee W's compensation for 1998 was $220,000. Employee W received a contribution of $17,600 for 1998 (8% of $220,000), rather than the contribution of $12,800 (8% of $160,000) provided by the plan for that year, resulting in an improper allocation of $4,800.

Correction:

The § 401(a)(17) failure is corrected using the reduction of account balance method by reducing Employee W's account balance by $4,800 (adjusted for earnings) and crediting that amount to an unallocated account, similar to the suspense account described in § 1.415–6(b)(6)(iii), to be used to reduce employer contributions in succeeding year(s).

.07 *Correction by Amendment Under VCP and SCP*.

(1) § 401(a)(17) Failures. (a) Contribution Correction Method. In addition to the reduction of account balance correction method under section 2.06 of this Appendix B, an employer may correct a § 401(a)(17) failure for a plan year under a defined contribution plan under VCP and SCP (in accordance with the requirements of sections 8, 10, and 11) by using the contribution correction method set forth in this paragraph. The employer contributes an additional amount on behalf of each of the other employees (excluding each employee for whom there was a § 401(a)(17) failure) who received an allocation for the year of the failure, amending the plan (as necessary) to provide for the additional allocation. The amount contributed for an employee is equal to the employee's plan compensation for the year of the failure multiplied by a fraction, the numerator of which is the improperly allocated amount made on behalf of the employee with the largest improperly allocated amount, and the denominator of which is the limit under § 401(a)(17) applicable to the year of the failure. The resulting additional amount for each of the other employees is adjusted for earnings. (See Example 20.)

(b) Examples.

Example 20:

The facts are the same as in Example 19.

Correction:

Employer J corrects the failure under VCP using the contribution correction method by (1) amending the plan to increase the contribution percentage for all eligible employees (other than Employee W) for the 1998 plan year and (2) contributing an additional amount (adjusted for earnings) for those employees for that plan year. To determine the increase in the plan's contribution percentage (and the additional amount contributed on behalf of each eligible employee), the improperly allocated amount ($4,800) is divided by the § 401(a)(17) limit for 1998 ($160,000). Accordingly, the plan is amended to increase the contribution percentage by 3 percentage points ($4,800/$160,000) from 8% to

11% . In addition, each eligible employee for the 1998 plan year (other than Employee W) receives an additional contribution of 3% multiplied by that employee's plan compensation for 1998. This additional contribution is adjusted for earnings.

(2) Hardship Distribution Failures. (a) Plan Amendment Correction Method. The Operational Failure of making hardship distributions to employees under a plan that does not provide for hardship distributions may be corrected under VCP and SCP using the plan amendment correction method set forth in this paragraph. The plan is amended retroactively to provide for the hardship distributions that were made available. This paragraph does not apply unless (i) the amendment satisfies § 401(a), and (ii) the plan as amended would have satisfied the qualification requirements of § 401(a) (including the requirements applicable to hardship distributions under § 401(k), if applicable) had the amendment been adopted when hardship distributions were first made available. (See Example 21.)

(b) Example.

Example 21:

Employer K, a for-profit corporation, maintains a 401(k) plan. Although plan provisions in 1998 did not provide for hardship distributions, beginning in 1998 hardship distributions of amounts allowed to be distributed under § 401(k) were made currently and effectively available to all employees (within the meaning of § l.401(a)(4)–4). The standard used to determine hardship satisfied the deemed hardship distribution standards in § 1.401(k)–1(d)(2). Hardship distributions were made to a number of employees during the 1998 and 1999 plan years, creating an Operational Failure. The failure was discovered in 2000.

Correction:

Employer K corrects the failure under VCP by adopting a plan amendment, effective January 1, 1998, to provide a hardship distribution option that satisfies the rules applicable to hardship distributions in § 1.401(k)–1(d)(2). The amendment provides that the hardship distribution option is available to all employees. Thus, the amendment satisfies § 401(a), and the plan as amended in 2000 would have satisfied § 401(a) (including § 1.401(a)(4)–4 and the requirements applicable to hardship distributions under § 401(k)) if the amendment had been adopted in 1998.

(3) Inclusion of Ineligible Employee Failure. (a) Plan Amendment Correction Method. The Operational Failure of including an ineligible employee in the plan who has not completed the plan's minimum age or service requirements may be corrected under VCP and SCP by using the plan amendment correction method set forth in this paragraph. The plan is amended retroactively to change the eligibility provisions to provide for the inclusion of the ineligible employee to reflect the plan's actual operations. The amendment may change the eligibility provisions with respect to only those ineligible employees that were wrongly included, and only to those ineligible employees, provided (i) the amendment satisfies § 401(a) at the time it is adopted, (ii) the amendment would have satisfied § 401(a) had the amendment been adopted at the earlier time when it is effective, and (iii) the employees affected by the amendment are predominantly nonhighly compensated employees.

(b) Example

Example 22:

Employer L maintains a 401(k) plan applicable to all of its employees who have at least six months of service. The plan is a calendar year plan. The plan provides that Employer L will make matching contributions based upon an employee's salary reduction contributions. In 2001, it is discovered that all four employees who were hired by Employer L in 2000 were permitted to make salary reduction contributions to the plan effective with the first weekly paycheck after they were employed. Three of the four employees are nonhighly compensated. Employer L matched these employees' salary reduction contributions in accordance with the plan's matching contribution formula. Employer L calculates the ADP and ACP tests for 2000 (taking into account the salary reduction and matching contributions that were made for these employees) and determines that the tests were satisfied.

Correction:

Employer L corrects the failure under SCP by adopting a plan amendment, effective for employees hired on or after January 1, 2000, to provide that there is no service eligibility requirement under the plan and submitting the amendment to the Service for a determination letter.

SECTION 3. EARNINGS ADJUSTMENT METHODS AND EXAMPLES

.01 *Earnings Adjustment Methods*. (1) In general. (a) Under section 6.02(4)(a) of this revenue procedure, whenever the appropriate correction method for an Operational Failure in a defined contribution plan includes a corrective contribution or allocation that increases one or more employees' account balances (now or in the future), the contribution or allocation is adjusted for earnings and forfeitures. This section 3 provides earnings adjustment methods (but not forfeiture adjustment methods) that may be used by an employer to adjust a corrective contribution or allocation for earnings in a defined contribution plan. Consequently, these earnings adjustment methods may be used to determine the earnings adjustments for corrective contributions or allocations made under the correction methods in section 2 and under the VCS correction methods in Appendix A. If an earnings adjustment method in this section 3 is used to adjust a corrective contribution or allocation, that adjustment is treated as satisfying the earnings adjustment requirement of section 6.02(4)(a) of this revenue procedure. Other earnings adjustment methods, different from those illustrated in this section 3, may also be appropriate for adjusting corrective contributions or allocations to reflect earnings.

(b) Under the earnings adjustment methods of this section 3, a corrective contribution or allocation that increases an employee's account balance is adjusted to reflect an "earnings amount" that is based on the earnings rate(s) (determined under section 3.01(3)) for the period of the failure (determined under section 3.01(2)). The earnings amount is allocated in accordance with section 3.01(4).

(c) The rule in section 6.02(5)(a) of this revenue procedure permitting reasonable estimates in certain circumstances applies for purposes of this section 3. For this purpose, a determination of earnings made in accordance with the rules of administrative convenience set forth in this section 3 is treated as a precise determination of earnings. Thus, if the probable difference between an approximate determination of earnings and a determination of earnings under this section 3 is insignificant and the administrative cost of a precise determination would significantly exceed the probable difference, reasonable estimates may be used in calculating the appropriate earnings.

(d) This section 3 does not apply to corrective distributions or corrective reductions in account balances. Thus, for example, while this section 3 applies in

increasing the account balance of an improperly excluded employee to correct the exclusion of the employee under the reallocation correction method described in section 2.02(2)(a)(iii)(B), this section 3 does not apply in reducing the account balances of other employees under the reallocation correction method. (See section 2.02(2)(a)(iii)(C) for rules that apply to the earnings adjustments for such reductions.) In addition, this section 3 does not apply in determining earnings adjustments under the one-to-one correction method described in section 2.01(1)(b)(iii).

(2) Period of the Failure. (a) General Rule. For purposes of this section 3, the "period of the failure" is the period from the date that the failure began through the date of correction. For example, in the case of an improper forfeiture of an employee's account balance, the beginning of the period of the failure is the date as of which the account balance was improperly reduced.

(b) Rules for Beginning Date for Exclusion of Eligible Employees from Plan. (i) General Rule. In the case of an exclusion of an eligible employee from a plan contribution, the beginning of the period of the failure is the date on which contributions of the same type (*e.g.*, elective deferrals, matching contributions, or discretionary nonelective employer contributions) were made for other employees for the year of the failure. In the case of an exclusion of an eligible employee from an allocation of a forfeiture, the beginning of the period of the failure is the date on which forfeitures were allocated to other employees for the year of the failure.

(ii) Exclusion from a 401(k) or (m) Plan. For administrative convenience, for purposes of calculating the earnings rate for corrective contributions for a plan year (or the portion of the plan year) during which an employee was improperly excluded from making periodic elective deferrals or employee after-tax contributions, or from receiving periodic matching contributions, the employer may treat the date on which the contributions would have been made as the midpoint of the plan year (or the midpoint of the portion of the plan year) for which the failure occurred. Alternatively, in this case, the employer may treat the date on which the contributions would have been made as the first date of the plan year (or the portion of the plan year) during which an employee was excluded, provided that the earnings rate used is one half of the earnings rate applicable under section 3.01(3) for the plan year (or the portion of the plan year) for which the failure occurred.

(3) Earnings Rate. (a) General Rule. For purposes of this section 3, the earnings rate generally is based on the investment results that would have applied to the corrective contribution or allocation if the failure had not occurred.

(b) Multiple Investment Funds. If a plan permits employees to direct the investment of account balances into more than one investment fund, the earnings rate is based on the rate applicable to the employee's investment choices for the period of the failure. For administrative convenience, if most of the employees for whom the corrective contribution or allocation is made are nonhighly compensated employees, the rate of return of the fund with the highest earnings rate under the plan for the period of the failure may be used to determine the earnings rate for all corrective contributions or allocations. If the employee had not made any applicable investment choices, the earnings rate may be based on the earnings rate under the plan as a whole (*i.e.*, the average of the rates earned by all of the funds in the valuation periods during the period of the failure weighted by the portion of the plan assets invested in the various funds during the period of the failure).

(c) Other Simplifying Assumptions. For administrative convenience, the earnings rate applicable to the corrective contribution or allocation for a valuation period with respect to any investment fund may be assumed to be the actual earnings rate for the plan's investments in that fund during that valuation period. For example, the earnings rate may be determined without regard to any special investment provisions that vary according to the size of the fund. Further, the earnings rate applicable to the corrective contribution or allocation for a portion of a valuation period may be a *pro rata* portion of the earnings rate for the entire valuation period, unless the application of this rule would result in either a significant understatement or overstatement of the actual earnings during that portion of the valuation period.

(4) Allocation Methods. (a) In General. For purposes of this section 3, the earnings amount generally may be allocated in accordance with any of the methods set forth in this paragraph (4). The methods under paragraph (4)(c), (d), and (e) are intended to be particularly helpful where corrective contributions are made at dates between the plan's valuation dates.

(b) Plan Allocation Method. Under the plan allocation method, the earnings amount is allocated to account balances under the plan in accordance with the plan's method for allocating earnings as if the failure had not occurred. (See Example 23.)

(c) Specific Employee Allocation Method. Under the specific employee allocation method, the entire earnings amount is allocated solely to the account balance of the employee on whose behalf the corrective contribution or allocation is made (regardless of whether the plan's allocation method would have allocated the earnings solely to that employee). In determining the allocation of plan earnings for the valuation period during which the corrective contribution or allocation is made, the corrective contribution or allocation (including the earnings amount) is treated in the same manner as any other contribution under the plan on behalf of the employee during that valuation period. Alternatively, where the plan's allocation method does not allocate plan earnings for a valuation period to a contribution made during that valuation period, plan earnings for the valuation period during which the corrective contribution or allocation is made may be allocated as if that employee's account balance had been increased as of the last day of the prior valuation period by the corrective contribution or allocation, including only that portion of the earnings amount attributable to earnings through the last day of the prior valuation period. The employee's account balance is then further increased as of the last day of the valuation period during which the corrective contribution or allocation is made by that portion of the earnings amount attributable to earnings after the last day of the prior valuation period. (See Example 24.)

(d) Bifurcated Allocation Method. Under the bifurcated allocation method, the entire earnings amount for the valuation periods ending before the date the corrective contribution or allocation is made is allocated solely to the account balance of the employee on whose behalf the corrective contribution or allocation is made. The earnings amount for the valuation period during which the corrective contribution or allocation is made is allocated in accordance with the plan's method for allocating other earnings for that valuation period in accordance with section 3.01(4)(b). (See Example 25.)

(e) Current Period Allocation Method. Under the current period allocation method, the portion of the earnings amount attributable to the valuation period during which the period of the failure begins ("first partial valuation period") is allocated in the same manner as earnings for the valuation period during which the corrective contribution or allocation is made in accordance section 3.01(4)(b). The earnings for the subsequent full valuation periods ending before the beginning of the valuation period during which the corrective contribution or allocation is made are allocated solely to the employee for whom the required contribution should have been made. The earnings amount for the valuation period during which the corrective contribution or allocation is made ("second partial valuation period") is allocated in accordance with the plan's method for allocating other earnings for that valuation period in accordance with section 3.01(4)(b). (See Example 26.)

.02 Examples.

Example 23:

Employer L maintains a profit-sharing plan that provides only for nonelective contributions. The plan has a single investment fund. Under the plan, assets are valued annually (the last day of the plan year) and earnings for the year are allocated in proportion to account balances as of the last day of the prior year, after reduction for distributions during the current year but without regard to contributions received during the current year (the "prior year account balance"). Plan contributions for 1997 were made on March 31, 1998. On April 20, 2000, Employer L determines that an operational failure occurred for 1997 because Employee X was improperly excluded from the plan. Employer L decides to correct the failure by using the VCS correction method for the exclusion of an eligible employee from nonelective contributions in a profit-sharing plan. Under this method, Employer L determines that this failure is corrected by making a contribution on behalf of Employee X of $5,000 (adjusted for earnings). The earnings rate under the plan for 1998 was +20% . The earnings rate under the plan for 1999 was +10% . On May 15, 2000, when Employer L determines that a contribution to correct for the failure will be made on June 1, 2000, a reasonable estimate of the earnings rate under the plan from January 1, 2000, to June 1, 2000 is +12%.

Earnings Adjustment on the Corrective Contribution:

The $5,000 corrective contribution on behalf of Employee X is adjusted to reflect an earnings amount based on the earnings rates for the period of the failure (March 31, 1998, through June 1, 2000) and the earnings amount is allocated using the plan allocation method. Employer L determines that a *pro rata* simplifying assumption may be used to determine the earnings rate for the period from March 31, 1998, to December 31, 1998, because that rate does not significantly understate or overstate the actual earnings for that period. Accordingly, Employer L determines that the earnings rate for that period is 15% (9/12 of the plan's 20% earnings rate for the year). Thus, applicable earnings rates under the plan during the period of the failure are:

Time Periods	Earnings Rate
3/31/98 — 12/31/98 (First Partial Valuation Period)	+15%
1/1/99 — 12/31/99	+10%
1/1/00 — 6/1/00 (Second Partial Valuation Period)	+12%

If the $5,000 corrective contribution had been contributed for Employee X on March 31, 1998, (1) earnings for 1998 would have been increased by the amount of the earnings on the additional $5,000 contribution from March 31, 1998, through December 31, 1998, and would have been allocated as 1998 earnings in proportion to the prior year (December 31, 1997) account balances, (2) Employee X's account balance as of December 31, 1998, would have been increased by the additional $5,000 contribution, (3) earnings for 1999 would have been increased by the 1999 earnings on the additional $5,000 contribution (including 1998 earnings thereon) allocated in proportion to the prior year (December 31, 1998) account balances along with other 1999 earnings, and (4) earnings for 2000 would have been increased by the earnings on the additional $5,000 (including 1998 and 1999 earnings thereon) from January 1 to June 1, 2000, and would be allocated in proportion to the prior year (December 31, 1999) account balances along with other 2000 earnings. Accordingly, the $5,000 corrective contribution is adjusted to reflect an earnings amount of $2,084 ($5,000[(1.15)(1.10)(1.12)–1]) and the earnings amount is allocated to the account balances under the plan allocation method as follows:

(a) Each account balance that shared in the allocation of earnings for 1998 is increased, as of December 31, 1998, by its appropriate share of the earnings amount for 1998, $750 ($5,000(.15)).

(b) Employee X's account balance is increased, as of December 31, 1998, by $5,000.

(c) The resulting December 31, 1998, account balances will share in the 1999 earnings, including the $575 for 1999 earnings included in the corrective contribution ($5,750(.10)), to determine the account balances as of December 31, 1999. However, each account balance other than Employee X's account balance has already shared in the 1999 earnings, excluding the $575. Accordingly, Employee X's account balance as of December 31, 1999, will include $500 of the 1999 portion of the earnings amount based on the $5,000 corrective contribution allocated to Employee X's account balance as of December 31, 1998 ($5,000(.10)). Then each account balance that originally shared in the allocation of earnings for 1999 (*i.e.*, excluding the $5,500 additions to Employee X's account balance) is increased by its appropriate share of the remaining 1999 portion of the earnings amount, $75.

(d) The resulting December 31, 1999, account balances (including the $5,500 additions to Employee X's account balance) will share in the 2000 portion of the earnings amount based on the estimated

January 1, 2000, to June 1, 2000, earnings included in the corrective contribution equal to $759 ($6,325 (.12)). (See Table 1.)

TABLE 1
CALCULATION AND ALLOCATION OF THE
CORRECTIVE AMOUNT ADJUSTED FOR EARNINGS

	Earnings Rate	Amount	Allocated to:
Corrective Contribution		$5,000	Employee X
First Partial Valuation Period Earnings	15%	750[1]	All 12/31/1997, Account Balances[4]
1999 Earnings	10%	575[2]	Employee X ($500)/ All 12/31/1998, Account Balances ($75)[4]
Second Partial Valuation Period Earnings	12%	759[3]	All 12/31/1999, Account Balances (including Employee X's $5,500)[4]
Total Amount Contributed		$7,084	

[1] $5,000 x 15%

[2] $5,750 ($5,000 +750) x 10%

[3] $6,325 ($5,000 +750 +575) x 12%

[4] After reduction for distributions during the year for which earning are being determined but without regard to contributions received during the year for which earnings are being determined.

Example 24:

The facts are the same as in Example 23.

Earnings Adjustment on the Corrective Contribution:

The earnings amount on the corrective contribution is the same as in Example 23, but the earnings amount is allocated using the specific employee allocation method. Thus, the entire earnings amount for all periods through June 1, 2000 (*i.e.*, $750 for March 31, 1998, to December 31, 1998, $575 for 1999, and $759 for January 1, 2000, to June 1, 2000) is allocated to Employee X. Accordingly, Employer L makes a contribution on June 1, 2000, to the plan of $7,084 ($5,000(1.15)(1.10)(1.12)). Employee X's account balance as of December 31, 2000, is increased by $7,084. Alternatively, Employee X's account balance as of December 31, 1999, is increased by $6,325 ($5,000(1.15)(1.10)), which shares in the allocation of earnings for 2000, and Employee X's account balance as of December 31, 2000, is increased by the remaining $759. (See Table 2.)

TABLE 2
CALCULATION AND ALLOCATION OF THE
CORRECTIVE AMOUNT ADJUSTED FOR EARNINGS

	Earnings Rate	Amount	Allocated to:
Corrective Contribution		$5,000	Employee X
First Partial Valuation Period Earnings	15%	750[1]	Employee X
1999 Earnings	10%	575[2]	Employee X
Second Partial Valuation Period Earnings	12%	759[3]	Employee X
Total Amount Contributed		$7,084	

[1] $5,000 x 15%

[2] $5,750 ($5,000 +750) x 10%

[3] $6,325 ($5,000 +750 +575) x 12%

Example 25:

The facts are the same as in Example 23.

Earnings Adjustment on the Corrective Contribution:

The earnings amount on the corrective contribution is the same as in Example 23, but the earnings amount is allocated using the bifurcated allocation method. Thus, the earnings for the first partial valuation period (March 31, 1998, to December 31, 1998) and the earnings for 1999 are allocated to Employee X. Accordingly, Employer L makes a contribution on June 1, 2000, to the plan of $7,084 ($5,000(1.15)(1.10)(1.12)). Employee X's account balance as of December 31, 1999, is increased by $6,325 ($5,000(1.15)(1.10)); and the December 31, 1999, account balances of employees (including Employee X's increased account balance) will share in estimated January 1, 2000, to June 1, 2000, earnings on the corrective contribution equal to $759 ($6,325(.12)). (See Table 3.)

TABLE 3
CALCULATION AND ALLOCATION OF THE
CORRECTIVE AMOUNT ADJUSTED FOR EARNINGS

	Earnings Rate	Amount	Allocated to:
Corrective Contribution		$5,000	Employee X
First Partial Valuation Period Earnings	15%	750[1]	Employee X
1999 Earnings	10%	575[2]	Employee X
Second Partial Valuation Period Earnings	12%	759[3]	12/31/99, Account Balances (including Employee X's $6,325)[4]
Total Amount Contributed		$7,084	

[1] $5,000 x 15%

[2] $5,750 ($5,000 +750) x 10%

[3] $6,325 ($5,000 +750 +575) x 12%

[4] After reduction for distributions during the 2000 year but without regard to contributions received during the 2000 year.

Example 26:

The facts are the same as in Example 23.

Earnings Adjustment on the Corrective Contribution:

The earnings amount on the corrective contribution is the same as in Example 23, but the earnings amount is allocated using the current period allocation method. Thus, the earnings for the first partial valuation period (March 31, 1998, to December 31, 1998) are allocated as 2000 earnings. Accordingly, Employer L makes a contribution on June 1, 2000, to the plan of $7,084 ($5,000 (1.15)(1.10)(1.12)). Employee X's account balance as of December 31, 1999, is increased by the sum of $5,500 ($5,000(1.10)) and the remaining 1999 earnings on the corrective contribution equal to $75 ($5,000(.15)(.10)). Further, both (1) the estimated March 31, 1998, to December 31, 1998, earnings on the corrective contribution equal to $750 ($5,000(.15)) and (2) the estimated January 1, 2000, to June 1, 2000, earnings on the corrective contribution equal to $759 ($6,325(.12)) are treated in the same manner as 2000 earnings by allocating these amounts to the December 31, 2000, account balances of employees in proportion to account balances as of December 31, 1999 (including Employee X's increased account balance). (See Table 4.) Thus, Employee X is allocated the earnings for the full valuation period during the period of the failure.

TABLE 4
CALCULATION AND ALLOCATION OF THE
CORRECTIVE AMOUNT ADJUSTED FOR EARNINGS

	Earnings Rate	Amount	Allocated to:
Corrective Contribution		$5,000	Employee X
First Partial Valuation Period Earnings	15%	750[1]	12/31/99, Account Balances (including Employee X's $5,575)[4]
1999 Earnings	10%	575[2]	Employee X
Second Partial Valuation Period Earnings	12%	759[3]	12/31/99, Account Balances (including Employee X's $5,575)[4]
Total Amount Contributed		$7,084	

[1] $5,000 x 15%

[2] $5,750 ($5,000 +750) x 10%

[3] $6,325 ($5,000 +750 +575) x 12%

[4] After reduction for distributions during the year for which earnings are being determined but without regard to contributions received during the year for which earnings are being determined.

APPENDIX C

VCP CHECKLIST
IS YOUR SUBMISSION COMPLETE?

INSTRUCTIONS

The Service will be able to respond more quickly to your VCP request if it is carefully prepared and complete. To ensure that your request is in order, use this checklist. Answer each question in the checklist by inserting yes, no, or N/A, as appropriate, in the blank next to the item. *Sign and date the checklist* (*as taxpayer or authorized representative) and place it on top of your request*.

You must submit a completed copy of this checklist with your request. If a completed checklist is not submitted with your request, substantive consideration of your submission will be deferred until a completed checklist is received.

TAXPAYER'S NAME_____

TAXPAYER'S I.D. NO._____

PLAN NAME & NO._____

ATTORNEY/P.O.A._____

The following items relate to all submissions:

_____ 1. Have you included a complete description of the failure(s) and the years in which the failure(s) occurred (including the years for which the statutory period has expired)? (See section 11.02(1) of Rev. Proc. 2002–47.) (Hereafter, all section references are to Rev. Proc. 2002–47.)

_____ 2. Have you included an explanation of how and why the failure(s) arose, including a description of the administrative procedures for the plan in effect at the time the failure(s) occurred? (See section 11.02(2) and (3).)

_____ 3. Have you included a detailed description of the method for correcting the failure(s) identified in your submission? This description must include, for example, the number of employees affected and the expected cost of correction (both of which may be approximated if the exact number cannot be determined at the time of the request), the years involved, and calculations or assumptions the Plan Sponsor used to determine the amounts needed for correction. In lieu of providing correction calculations with respect to each employee affected by a failure, you may submit calculations with respect to a representative sample of affected employees. However, the representative sample calculations must be sufficient to demonstrate each aspect of the correction method proposed. Note that each step of the correction method must be described in narrative form. (See section 11.02(4).)

_____ 4. Have you described the earnings or interest methodology (indicating computation period and basis for determining earnings or interest rates) that will be used to calculate earnings or interest on any corrective contributions or distributions? (As a general rule, the interest rate (or rates) earned by the plan during the applicable period(s) should be used in determining the earnings for corrective contributions or distributions.) (See section 11.02(5).)

If you inserted "N/A" for item 4, enter explanation:

_____

_____

_____

_____ 5. Have you submitted specific calculations for each affected employee or a representative sample of affected employees? (See section 11.02(6).)

_____ 6. Have you described the method that will be used to locate and notify former employees or, if there are no former employees affected by the failure(s) or the correction(s), provided an affirmative statement to that effect? (See section 11.02(7).)

_____ 7. Have you provided a description of the administrative measures that have been or will be implemented to ensure that the same failure(s) do not recur? (See section 11.02(8).)

_____ 8. Have you included a statement that, to the best of the Plan Sponsor's knowledge, the plan is not currently under an Employee Plans examination? (See section 11.02(9).)

_____ 9. Have you included a statement that, to the best of the Plan Sponsor's knowledge, the Plan Sponsor is not under an Exempt Organizations examination? (See section 11.02(9).)

_____ 10. If the submission includes a failure related to Transferred Assets, have you included a description of the related employer transaction, including the date of the employer transaction and the date the assets were transferred to the plan?

_____ 11. Have you included a copy of the portions of the plan document (and adoption agreement, if applicable) relevant to the failure(s) and method(s) of correction? (See section 11.04(2).)

_____ 12. Have you included a copy of the plan's most recent Favorable Letter and/or the required applicable document(s)? (See section 11.04(4).)

_____ 13. Have you included the appropriate voluntary compliance fee due with the submission? (See section 11.06.)

_____ 14. Have you included the original signature of the sponsor or the sponsor's authorized representative? (See section 11.07.)

_____ 15. Have you included a Power of Attorney (Form 2848)? Note: representation under VCP is limited to attorneys, certified public accountants, enrolled agents, and enrolled actuaries; unenrolled return preparers are not eligible to act as representatives under VCP. (See section 11.08.)

_____ 16. Have you included a Penalty of Perjury Statement signed (original signature only) and dated by the Plan Sponsor? (See section 11.09.)

_____ 17. Have you designated your submission as a VCP, VCO, VCS, VCT, VCSEP, VCGroup, or Anonymous Submission Procedure, as appropriate? (See section 11.11.)

_____ 18. If you are requesting a waiver of the excise tax under § 4974 of the Code, have you included the request, and, if applicable, an explanation supporting the request for any affected owner-employee or 10 percent owner? (See section 6.07(3).)

_____ 19. Have you submitted an application for a determination letter? (See section 10.06.)

_____ 20. If the plan is currently being considered in a determination letter application, have you included a statement to that effect? (See section 11.03(1).)

The following items relate only to submissions under VCO (including VCS):

_____ 21. Have you included a copy of the first page, the page containing employee census information (currently line 7f of the 1998 Form 5500), and the information relating to plan assets (currently line 31f of the 1998 Form 5500) of the most recently filed Form 5500 series return? Note: If a Form 5500 is not applicable, insert N/A and furnish the name of the plan, and the census information required of Form 5500 series filers. (See section 11.04(1)(b).)

_____ 22. Have you proposed a time period of correction that is limited to 150 days (240 days for VCGroup) from the date the compliance statement is issued? (See sections 10.06(8) and 10.14(3)(b).)

The following items relate only to submissions under VCS:

_____ 23. Are each of the failures you have identified eligible for correction under VCS? (See Appendix A and Appendix B.)

_____ 24. Have you identified no more than two VCS failures? (If more than two failures were identified, VCS is not available, but you may make a submission under VCO.) (See section 10.11(3).)

_____ 25. Have you proposed to correct the failure(s) identified in your request using the permitted correction method(s) set forth in Appendix A or Appendix B? (See Appendix A and Appendix B.)

The following item relates only to submissions under VCGroup:

_____ 26. Have you submitted a certified or cashier's check for the initial fee of ten thousand dollars ($10,000) made payable to the U.S. Treasury?

The following item relates only to submissions under the general procedures of VCP:

_____ 27. Have you included a copy of the most recently filed Form 5500? (See section 11.04(1)(b).)

Signature

Date

Title or Authority

Typed or printed name of person signing checklist

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, §§ 61, 451, 1001)

Rev. Proc. 2002–49

SECTION 1. PURPOSE

This revenue procedure sets forth a manner in which an electric utility company may treat a transaction in which the utility is issued a financing order by a State agency authorizing the recovery of certain costs incurred by the utility.

SECTION 2. BACKGROUND

In general, State public utility commissions set rates for public utility companies that are calculated to allow for the recovery of prudently incurred costs. In the case of capital expenditures, rates are set to allow recovery of costs over an extended period of time. With the advent of restructuring and a competitive marketplace, these rates are no longer guaranteed. Thus, the recovery of previously incurred costs associated with generation facilities that have market values below their book value, as well as costs associated with contracts to purchase electricity at above-market prices, have become uncertain. Some States have enacted legislation to allow the recovery of these costs through a non-bypassable surcharge to customers upon their consumption of electricity within the utility's historic service area. These statutes, which also authorize securitization of the surcharge, are unique to the regulated utility industry. Accordingly, the law and analysis applied to these transactions is peculiar to this situation.

SECTION 3. SCOPE

This revenue procedure applies to investor-owned public utility companies that, pursuant to transition legislation, receive an irrevocable financing order from an appropriate State agency determining the amount of transition costs the utility will be permitted to recover through qualifying securitization of an intangible property right created under the transition legislation.

SECTION 4. DEFINITIONS

.01 PUBLIC UTILITY COMPANY

For purposes of this revenue procedure, the terms "public utility" or "utility" refer to a utility company that is subject to the regulatory authority of the State public utility commission or other appropriate State agency.

.02 TRANSITION LEGISLATION

For purposes of this revenue procedure, transition legislation is legislation that:

(1) is enacted by a State to facilitate the conversion from a wholly regulated public utility regime to a competitive environment caused by restructuring of the public utility industry within the State;

(2) authorizes the utility to apply for, and authorizes the public utility commission or other appropriate State agency to issue, a financing order determining the amount of transition costs the utility will be allowed to recover;

(3) provides that pursuant to the financing order, the utility acquires an intangible property right to charge, collect, and receive charges in a fixed amount necessary to provide for the full recovery of the transition costs determined to be recoverable, and assures that the charges are non-bypassable and will be paid by customers within the utility's traditional service territory who receive electricity through the utility's transmission and distribution system, even if those customers elect to purchase electricity from a third-party generator;

(4) guarantees that neither the State nor any agency thereof has the authority to rescind or amend the financing order, to revise the amount of transition costs, or in any way to reduce or impair the value of the intangible property right, except as may be contemplated by periodic adjustments authorized by the transition legislation;

(5) provides procedures assuring that the sale, assignment or other transfer of the intangible property right from the utility to a financing entity will be perfected under State law as an absolute transfer of the utility's right, title and interest in the property; and

(6) authorizes the securitization of the intangible property right to recover

the fixed amount of transition costs through the issuance of bonds, notes, certificates of participation or beneficial interest or other evidences of indebtedness issued pursuant to an indenture, contract or other agreement of an electric utility or a financing entity.

.03 TRANSITION COSTS

For purposes of this revenue procedure, transition costs are the utility's noneconomic costs caused by restructuring and the introduction of a competitive marketplace for electric services, and such other related costs that the State legislature may deem appropriate.

.04 QUALIFYING SECURITIZATION

For purposes of this revenue procedure, qualifying securitization is an issuance of any bonds, notes, certificates of participation or beneficial interests or other evidences of indebtedness—

(1) secured by the intangible property right to collect charges for the recovery of transition costs and such other assets, if any, of the financing entity;

(2) initially capitalized by the utility with at least 0.5 percent of the total principal amount of each series of evidences of indebtedness issued; and

(3) providing for self-amortizing level payments of interest and principal on a quarterly or semiannual basis.

SECTION 5. APPLICATION

.01 The utility will be treated as not recognizing gross income upon:

(1) the receipt of a financing order that creates an intangible property right in the amount of transition costs that may be recovered through securitization;

(2) the receipt of cash or other valuable consideration in exchange for the transfer of that property right to a financing entity; or

(3) the receipt of cash or other valuable consideration in exchange for securitized evidences of indebtedness issued by the financing entity.

.02 The securitized evidences of indebtedness described in Section 4.04 will be treated as obligations of the utility.

.03 The non-bypassable charges are gross income to the utility recognized under the utility's usual method of accounting.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective July 22, 2002.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Thomas Preston of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure, contact Mr. Preston at (202) 622–3940 (not a toll-free call).

Rev. Proc. 2002–50

26 CFR 1.6045–1: Returns of Information of brokers and barter exchanges.
(Also Part III, §§ 83, 421, 422, 423, 1001, 1011, 3121, 3306, 3401, 3402, 6041, 6051.)

SECTION 1. PURPOSE

This revenue procedure provides an exception from reporting on Form 1099–B, "*Proceeds From Broker and Barter Exchange Transactions*", for transactions involving an employee, former employee, or other service provider (a "service provider") who has obtained a stock option in connection with the performance of services. Where the service provider purchases stock through the exercise of the stock option and sells that stock on the same day through a broker, the broker executing such a sale is not required to report the sale on Form 1099–B, provided certain conditions are met.

SECTION 2. BACKGROUND

.01 *Tax treatment of stock options*. Section 83 of the Internal Revenue Code governs the tax treatment of nonstatutory stock options granted in connection with the performance of services. Sections 421 through 424 govern the tax treatment of statutory stock options, *i.e.*, incentive stock options described in § 422(b) and options granted under an employee stock purchase plan described in § 423(b). A stock option is not taxable when granted, provided the option either lacks "a readily ascertainable fair market value" as defined in § 1.83–7(b) of the Income Tax Regulations or meets the requirements of § 422 or § 423.

For nonstatutory stock options that lack a readily ascertainable fair market value, the service provider generally recognizes income at the time of the exercise of the options, in an amount generally equal to the fair market value of the stock received (disregarding lapse restrictions) minus the amount paid for that stock. See § 83(a) and § 1.83–7. The time for recognizing this income and for determining the fair market value of the stock is the first day that the transferee's rights in the stock are "substantially vested", *i.e.*, transferable or not subject to a substantial risk of forfeiture. Where the individual exercising such options is an employee, the taxable compensation income generated by § 83(a) constitutes wages for purposes of §§ 3121, 3306, and 3401.

For statutory stock options, if the individual receiving the statutory stock option satisfies the employment requirements of § 422(a) or § 423(a), the exercise of the stock option produces taxable income only when the stock acquired pursuant to the exercise of the option is sold or disposed of. If that stock is sold in a disqualifying disposition (*i.e.*, prior to the later of the date that is one year after the exercise of the option and two years after the grant of the option), certain amounts will be taxable compensation income under § 83(a). In addition, pursuant to § 423(c), where the holding periods are satisfied, and where the stock options under an employee stock purchase plan are offered at an exercise price below the fair market value of the stock at the date of grant, certain amounts may be included as compensation income at the time of disposition of the stock acquired at exercise of the option.

Notice 2002–47, 2002–28 I.R.B. 97, provides, in part, that until the Treasury Department and the Internal Revenue Service issue further guidance, in the case of a statutory stock option, the Service will not assess the Federal Insurance Contributions Act (FICA) tax or Federal Unemployment Tax Act (FUTA) tax, or apply federal income tax withholding obligations, upon either the exercise of the option or the disposition of the stock acquired by an employee pursuant to the exercise of the option.

Section 1001 dictates the tax consequences when substantially vested stock obtained through the exercise of an option is sold. Pursuant to § 1001(a), the gain from sale of the stock is the amount realized minus the adjusted basis provided in § 1011, and the loss is the adjusted basis provided in § 1011 minus the amount realized. For this purpose, the adjusted basis of the stock includes the amount included in gross income under § 83(a) upon exercise of an option that did not have a readily ascertainable fair market value at grant.

.02 *Information reporting — Form W–2 and Form 1099*. Section 6051 provides generally that an employer must annually report to each of its employees the total wages paid to the employee. Compensation income constitutes "wages" for purposes of this reporting obligation. Form W–2 is used to report the information required by § 6051.

Section 6041 provides that where a person engaged in a trade or business makes payments in the course of the trade or business to another person of compensation of $600 or more in a taxable year, the person must render a return, in accordance with such regulations as the Secretary may prescribe, that sets forth the amount of the income, and the name and address of the recipient of the payment. Forms in the 1099 series are generally used to report the information required by § 6041 where the compensation income does not constitute wages, such as where the service provider does not provide the services as an employee of the service recipient.

.03 *Information reporting — Form 1099–B*. Section 6045(a) provides that brokers, when required to do so by the Secretary, must make a return in accordance with such regulations as the Secretary may prescribe regarding transactions they carry out for customers.

Section 1.6045–1(c)(2) of the regulations states, in general, that each broker must make a return of information with respect to each sale by a customer effected by the broker.

Section 1.6045–1(d)(2) provides, in part, that a broker must report the gross proceeds of a stock sale.

Section 1.6045–1(d)(5) provides that the broker may, but is not required to, take commissions and option premiums into account in determining gross proceeds provided the treatment chosen is consistent with the books of the broker. Form 1099–B is used to report the information required by § 6045 and the regulations thereunder.

Section 1.6045–1(c)(3)(ii) states that no return of information is required with respect to a sale effected by a broker for a customer if the sale is an excepted sale. This regulation defines an "excepted sale" as one so designated by the Internal Revenue Service in a revenue ruling or revenue procedure published in the Internal Revenue Bulletin.

SECTION 3. SCOPE

.01 *Applicability*. The exception provided by this revenue procedure applies to a sale of stock acquired by a service provider through the exercise of an option if:

(1) the sale is executed for the service provider on the same day that the stock being sold is acquired through the exercise of an option;

(2) the option was granted in connection with the performance of services, such that the federal tax consequences of the transactions are governed by section 83 of the Code (*e.g.*, an exercise of a nonstatutory stock option granted in exchange for services or an exercise of a statutory stock option followed by a disqualifying disposition of the stock acquired pursuant to the exercise);

(3) the service recipient certifies in writing to the broker that the service recipient will report any compensation income generated by the exercise of the option, or disposition of the stock acquired pursuant to the exercise of the option, in accordance with section 6041 (Form 1099) or section 6051 (Form W–2), as applicable; and

(4) the broker either:

(a) does not charge a commission or other fee on the transaction; or

(b) does charge a commission or other fee on the transaction and furnishes to the service provider the written statement described in section 4.03 of this revenue procedure.

.02 *Inapplicability*. The exception provided by this revenue procedure does not apply if the service recipient uses an amount other than the sale price of the shares to calculate the compensation income generated to the service provider by the option exercise. This revenue procedure also does not apply to the exercise of a stock option if, at the date of grant, the stock option had a readily ascertainable fair market value as defined in § 1.83–7(b).

SECTION 4. PROCEDURE

.01 *General*. A broker may treat a sale as an "excepted sale" for purposes of § 1.6045–1(c)(3)(ii) if an employee, former employee or other service provider obtains substantially vested shares of stock from the exercise of an option and on the same day sells the shares through a broker.

.02 *Statement to broker*. To determine whether the service provider exercised the option and sold the underlying shares on the same day, the broker may rely on a receipt or written statement provided by the service recipient or the service provider showing the date of exercise. To determine whether the service recipient uses the sale price of the shares to calculate the compensation income generated to service providers by the option exercise, the broker may rely upon a written statement from the service recipient certifying that it follows that practice.

.03 *Statement to customer*. Under the circumstances described in section 3.01(4)(b) of this revenue procedure, the broker must furnish the service provider with a statement containing the following information:

(1) the gross sales price with respect to the shares sold through the broker;

(2) the commissions or other fees charged by the broker on the sale; and

(3) a description of how gain or loss with respect to shares obtained through the option exercise is calculated and the manner in which such gain or loss should be reported on a federal income tax return. The description need not be an

independent document, but may be incorporated in a document such as a settlement sheet provided to the broker's customer in connection with the sale.

SECTION 5. EXAMPLES

.01 *Example 1*. An employee holds an option for 100 shares of Company A stock at an exercise price of $20 per share. When granted, the option had no readily ascertainable fair market value. The employee exercises the option on January 15, 2003, receives substantially vested shares and immediately sells the shares for the fair market value of $30 per share. The sale is executed by a broker rendering its services to Company A employees through a contractual arrangement with Company A. The broker charges no commissions or other fees to the employee in connection with the sale of the shares. Company A uses the sale price of the shares to calculate the compensation income of the employee reported as wages on Form W–2.

Under these facts, the employee has compensation income of $10 per share under § 83(a) ($30 fair market value minus $20 exercise price). Company A certifies in writing to the broker that it will report $1,000 as wages of the employee, and includes that amount on the employee's Form W–2. The employee's basis is $30 per share ($20 cost of exercising the option plus $10 taxable income recognized). Because the employee's amount realized on the sale of the stock ($30 per share) equals his basis, the employee has no capital gain or loss on the sale. The broker is not required to report the proceeds of the sale on Form 1099–B.

.02 *Example 2*. Assume the same facts as *Example 1*, except that the employee pays a commission of $.05 per share to the broker. The employee's compensation income is $10 per share ($30 fair market value of stock received minus $20 exercise price). Company A reports $1,000 as wages on the employee's Form W–2 (as in *Example 1*), since commission expense does not reduce the income generated by the exercise. The employee has a loss of $5.00 ($.05 per share times 100 shares). Because the employee realizes a loss, "excepted sale" treatment will apply only if the broker provides the statement required by section 4.03 to the employee.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for sales of stock occurring after December 31, 2001.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Nathan Rosen of the Office of the Associate Chief Counsel (Procedure & Administration), Administrative Provisions and Judicial Practice Division. For further information regarding this revenue procedure, contact Mr. Rosen at (202) 622–4910 (not a toll free call).

Note: This revenue procedure will be reprinted as the next revision of IRS Publication 1223, *General Rules and Specifications for Substitute Forms W–2c and W–3c*.

Rev. Proc. 2002–51

TABLE OF CONTENTS

Section 1 — Purpose.

.01 The purpose of this revenue procedure is to state the requirements of the Internal Revenue Service (IRS) and the Social Security Administration (SSA) relating to substitutes for **Form W–2c**, *Corrected Wage and Tax Statement*, and **Form W–3c**, *Transmittal of Corrected Wage and Tax Statements*, for:

- Preparing acceptable substitutes of the official IRS forms to file information returns with the IRS and SSA, and

- Using official or acceptable substitute forms to furnish information to recipients.

.02 The official IRS Form W–2c is a six-part form and the official IRS Form W–3c is a one-part form. **Paper substitutes conforming to the specifications contained in this document may be privately-printed without the prior approval of the IRS or the SSA.**

Note: *Both paper substitute forms filed with the SSA and those furnished to employees that do not conform totally to these specifications are not acceptable. Forms W–2c (Copy A) and Forms W–3c that do not conform may be returned. In addition, penalties may be assessed*.

.03 Forms should not be submitted to either the IRS or the SSA for specific approval. If you are uncertain of any specification and want it clarified, you may submit a letter citing the specification, state your understanding and interpretation of the specification, and enclose an example of the form (if appropriate) to:

Internal Revenue Service
Attn: Substitute Forms Program
W:CAR:MP:FP:S:SP
1111 Constitution Ave., NW
Room 6411 IR
Washington, DC 20224

You may also contact the Substitute Forms Program Unit via e-mail at **taxforms@irs.gov*. Please enter "Substitute Forms" on the Subject Line.

Note: *Allow at least 45 days for the IRS to respond.*

Section 2 — Nature of Changes.

.01 The following changes have been made since the last revision (March 1995) of Publication 1223:

- The text and exhibits have been extensively updated throughout the publication.
- A new checkbox, "Third-party sick pay," has been added to box 13 of Form W–2c and box c, "Kind of Payer," on Form W–3c.
- A Form W–3c is required to be included whenever you file a Form W–2c with the Social Security Administration (SSA), even if you are only filing Form W–2c to correct an employee's name and/or social security number (SSN).
- Copy A of Form W–2c and Form W–3c must be printed on 8.5–inch by 11 inch paper using the revised formats and nonreflective black ink. Form identification numbers "44444" and "55555", respectively, were added to the top of Forms W–2c and W–3c.
- Filers are instructed to use 12-point Courier font (SSA-preferred) for data entries in order to facilitate processing.

Section 3 — Filing Forms W–2c and W–3c on Magnetic Media or Electronically

.01 Employers with less than 250 Forms W–2 to be corrected are encouraged to file electronically or use magnetic media for filing Forms W–2c (Copy A) with the SSA. Employers **must** use magnetic or electronic media for filing with the SSA if they file 250 or more Forms W–2c (Copy A) during a calendar year.

.02 To submit Forms W–2c on magnetic media or electronically, contact the Employer Service Liaison Officer (ESLO) for your state. Call 1–800–772–6270 for your ESLO's phone number. Specifications for filing Form W–2c on magnetic media or electronically are contained in SSA's **MMREF–2**, *Magnetic Media Reporting and Electronic Filing of W–2c Information*. As noted above, employers filing less than 250 Forms W–2c are not required to file on magnetic media or electronically. However, doing so will enhance the timeliness and accuracy of forms processing.

.03 You can also get information from the SSA's Business Services Online (BSO). You can access BSO by visiting the SSA Website at *www.ssa.gov/employer* or by calling 410–966–4105 (not a toll-free number). Call the SSA at 1–888–772–2970 if you experience problems using BSO. Information available includes Forms W–2c magnetic media filing instructions, information on electronic filing, selected IRS and SSA forms and publications, and general topics about information reporting. BSO can also be used to ask questions about those same items.

Section 4 — General Requirements for Substitute Paper Copies of Forms W–2c (Copy A) and W–3c That Payers Submit to SSA

.01 Include the OMB Number on Forms W–2c (Copy A) and Form W–3c in the same location as on the official form.

.02 The words "For Privacy Act and Paperwork Reduction Act Notice, see separate instructions." **must** be printed on all Forms W–2c (Copy A) and Form W–3c.

.03 The Government Printing Office (GPO) symbol must **not** be printed on substitute Forms W–2c (Copy A) and Form W–3c.

.04 The Catalog Number (Cat. No.) shown on the forms is used for IRS distribution purposes and should not be printed on any substitute forms.

.05 The SSA addresses must be printed on the front of Form W–3c below the body of the form (see Exhibit B). They are:

If you use the **U.S. Postal Service**:

Social Security Administration
Wilkes-Barre Data Operations
Center
P.O. Box 3333
Wilkes-Barre, PA 18767–3333.

If you use a **carrier other than the U.S. Postal Service**:

Social Security Administration
Wilkes-Barre Data Operations
Center
Attn: W–2c Process
1150 E. Mountain Drive
Wilkes-Barre, PA 18702–7997.

.06 The sequence for assembling the copies of Form W–2c is:

Copy A — For Social Security Administration
Copy 1 — For State, City, or Local Tax Department
Copy B — To Be Filed With Employee's FEDERAL Tax Return
Copy C — For EMPLOYEE'S RECORDS
Copy 2 — To Be Filed With Employee's State, City, or Local Income Tax Return
Copy D — For Employer

.07 Substitute form printers are **required** to include their Employer Identification Numbers (EINs) to the left of "Department of the Treasury" in the lower right of Forms W–2c and W–3c in place of "Cat. No."

.08 Employers may file privately-printed Forms W–2c (Copy A) and Form W–3c with the SSA. The substitute form must be an **exact** replica of the IRS-printed form with respect to layout and content.

.09 The back of substitute Forms W–2c (Copy A) and Form W–3c must be free of all printing.

.10 In addition:

- Hot wax and cold carbon spots are not permitted on any of the internal form plies.
- Color and paper quality for Copy A (cut sheets and continuous pinfeed forms) as specified by JCP Code 0–25, dated November 29, 1978, must be white 100% bleached chemical wood, optical character recognition (OCR) bond.
  Note: *Reclaimed fiber in any percentage is permitted provided the requirements of this standard are met.*
- Chemical transfer paper is permitted for Copy A only if:
  (a) chemically-**backed**;
  (b) you do not use carbon-coated forms; and
  (c) chemically-transferred images are black.
- All copies must be **clearly legible**. **Interleaved carbon** should be black and must be of good quality to assure legibility on all copies and to avoid smudging. Fading must be minimized to assure legibility.
- All copies should be legible and able to be photocopied.
- The contractor must initiate or have a quality control program to assure OCR ink density. The forms must be printed in nonreflective black ink.

.11 Type must be substantially identical in size and shape to the official form. All rules are either 1/2-point or 3/4-point. Rules must be identical to those on the official IRS form.

Note: *The form identifying number must be nonreflective carbon-based black ink in OCR A font.*

.12 Two official Forms W–2c or one W–3c are contained on a single page that is 8.5 inches wide (exclusive of any snap stubs) by 11 inches deep. The width of a substitute form must be 7.5 inches. See Exhibits A and B.

.13 Forms W–2c (Copy A) of privately-printed, continuous substitute forms must be perforated at each 11" page depth. No perforations are allowed between the forms on a single page of Copies A.

Note: *Perforations are required between all the other individual copies (Copies 1, B, C, 2, and D).*

Section 5 — Requirements for Substitute Privately-Printed Forms W–2c (Copies B, C, and 2) Furnished to Employees

.01 All employers (including those who file on magnetic media or electronically) must furnish employees with at least two copies of Form W–2c (three or more for employees required to file a state, city, or local income tax return).

.02 The paper for all copies **must** be white and printed in black ink. The substitute Copy B (or its equal), which employees are instructed to attach to their federal income tax returns, must be at least 12-pound paper (basis 17 x 22-500). Other copies furnished to the employee must be at least 9-pound paper (basis 17 x 22-500).

.03 Interleaved carbon and chemical transfer paper for employee copies **must** be clearly legible, have the capability to be photocopied, and not fade to such a degree as to preclude legibility and the ability to photocopy.

.04 Type must be substantially identical in size and shape to that on the official form.

.05 Substitute forms for employees need to contain only the payment boxes and captions that are applicable. These boxes, box numbers, and box titles **must**, when applicable, match the IRS-printed form. In all cases, the employee name, address, and SSN must be present.

.06 The dimensions of these copies (Copies B, C, and 2), but not Copy A, may be expanded from the dimensions of the official form to allow space for conveying additional information. Also, on these copies (Copies B, C, and 2), the size of the boxes may be adjusted. This may permit the employer to eliminate other statements or notices that would otherwise be furnished to employees.

.07 The **maximum** allowable dimensions for employee copies of Form W–2c are no more than 6.5 inches deep by 8.5 inches wide. The **minimum** allowable dimensions for employee copies of Form W–2c are 2.67 inches deep by 4.25 inches wide.

Note: *These maximum and minimum size specifications are subject to future change*.

.08 Either horizontal or vertical format is permitted for substitute employee copies of Forms W–2c. That is, the width of the form may be either greater or less than the depth of the form.

.09 All copies of Form W–2c **must** clearly show the form number and the form title prominently displayed together in one area of the form. It is recommended (but not required) that this be located on the bottom left of Form W–2c. The reference to the "Department of the Treasury — Internal Revenue Service" **must** be on all copies of Form W–2c. It is recommended (but not required) that this be located on the bottom right of Form W–2c.

.10 If the substitute Forms W–2c are *not labeled* as to the disposition of the copies, then written notification **must** be provided to each employee as specified below:

- The first copy of Form W–2c (Copy B) is filed with the employee's federal tax return.
- The second copy of Form W–2c (Copy C) is for the employee's records.
- If applicable, the third copy (Copy 2) of Form W–2c is filed with the employee's state, city, or local income tax return.

If the substitute Forms W–2c are *labeled*, the forms **must** contain the applicable description as stated on the official form.

.11 Instructions similar to those on the back of Form W–2c (Copy C) of the official form must be provided to each employee.

Section 6 — Instructions for Employers

.01 Privately-printed substitute Forms W–2c are not required to contain a copy to be retained by employers (Copy D). However, employers **must** be prepared to verify or duplicate this information if the IRS or the SSA requests it. Paper filers who do not keep Copy D of Form W–2c should be able to generate a facsimile of Form W–2c (Copy A) in case of loss.

.02 If Copy D is provided for the employer, instructions contained on the back of Copy D of the official form must appear on the back of the substitute form. If Copy D is not provided, these instructions must be furnished to the employer on a separate statement.

.03 Only originals or compliant substitute copies of Forms W–2c and Forms W–3c may be filed with the SSA. CARBON COPIES AND PHOTOCOPIES ARE NOT ACCEPTABLE.

.04 Employers should type or machine print entries on non-laser generated forms whenever possible and provide good quality data entries by using a high quality type face, inserting data in the middle of blocks that are well separated from other printing and guidelines, and taking any other measures that will guarantee clear, sharp images.

.05 Because employers must file a machine-scannable Form W–2c, be aware of the following requirements. Use 12-point Courier (SSA-preferred) font for data entries. Proportional-spaced fonts are unacceptable. You must refrain from printing any data in the top margin of the forms

.06 The employer must also furnish payee copies of Forms W–2c (Copies B, C, and 2) that are legible and capable of being photocopied (by the employee).

.07 When Forms W–2c or W–3c are typed, black ink **must** be used with no script type, inverted font, italics or dual-case alpha characters.

.08 The filer's Employer Identification Number (EIN) **must** be entered in box e of Form W–3c and is a preferred entry in box e of Form W–2c.

.09 The employer's name, address, EIN, and state ID number may be preprinted.

Section 7 — OMB Requirements for Substitute Forms

.01 The Paperwork Reduction Act (the Act) of 1995 (Public Law 104–13) requires that:

- The OMB approves all IRS tax forms that are subject to the Act.
- Each IRS form contains (in or near the upper right corner) the OMB approval number, if any. (The official OMB numbers may be found on the official IRS printed forms and are also shown in the exhibits.)
- Each IRS form (or its instructions) states:
  1. Why the IRS needs the information,
  2. How it will be used, and
  3. Whether or not the information is required to be furnished to the IRS.

.02 This information must be provided to any users of official or substitute IRS forms or instructions.

.03 The OMB requirements for **substitute** IRS forms are:

- Any substitute form or substitute statement to a recipient must show the OMB number as it appears on the official IRS form.
- For Form W–3c and Copy A of Form W–2c, the OMB number must appear exactly as shown on the official IRS form.
- For any copy other than Copy A, the OMB number must use one of the following formats.
  1. OMB No. XXXX-XXXX (preferred) or
  2. OMB # XXXX-XXXX (acceptable).

.04 All substitute Forms W–3c and Copy A of Form W–2c must state, "For Privacy Act and Paperwork Reduction Act Notice, see separate instructions." If no instructions are provided to users of your forms, you must furnish them the exact text of the Privacy Act and Paperwork Reduction Act Notice.

Section 8 — Reproducible Copies of Forms

.01 You can order official IRS forms and information copies of federal tax materials by calling the IRS Distribution Center at 1–800–829–3676. Other ways to get federal tax material include:

- The Internet.
- CD-ROM.
- GPO Superintendent of Documents Bookstores.

Note: *Several IRS forms are provided electronically on the IRS Website and on the federal tax forms CD-ROM, but Form W–3c and Copy A of Form W–2c downloaded from these sources cannot be used for filing because fileable forms must comply with specifications contained in this publication. These forms contain special scannable requirements.*

.02 You can access the IRS Website on the Internet via:

- File Transfer Protocol (FTP) using *ftp.irs.gov* or
- World Wide Web by using *www.irs.gov*

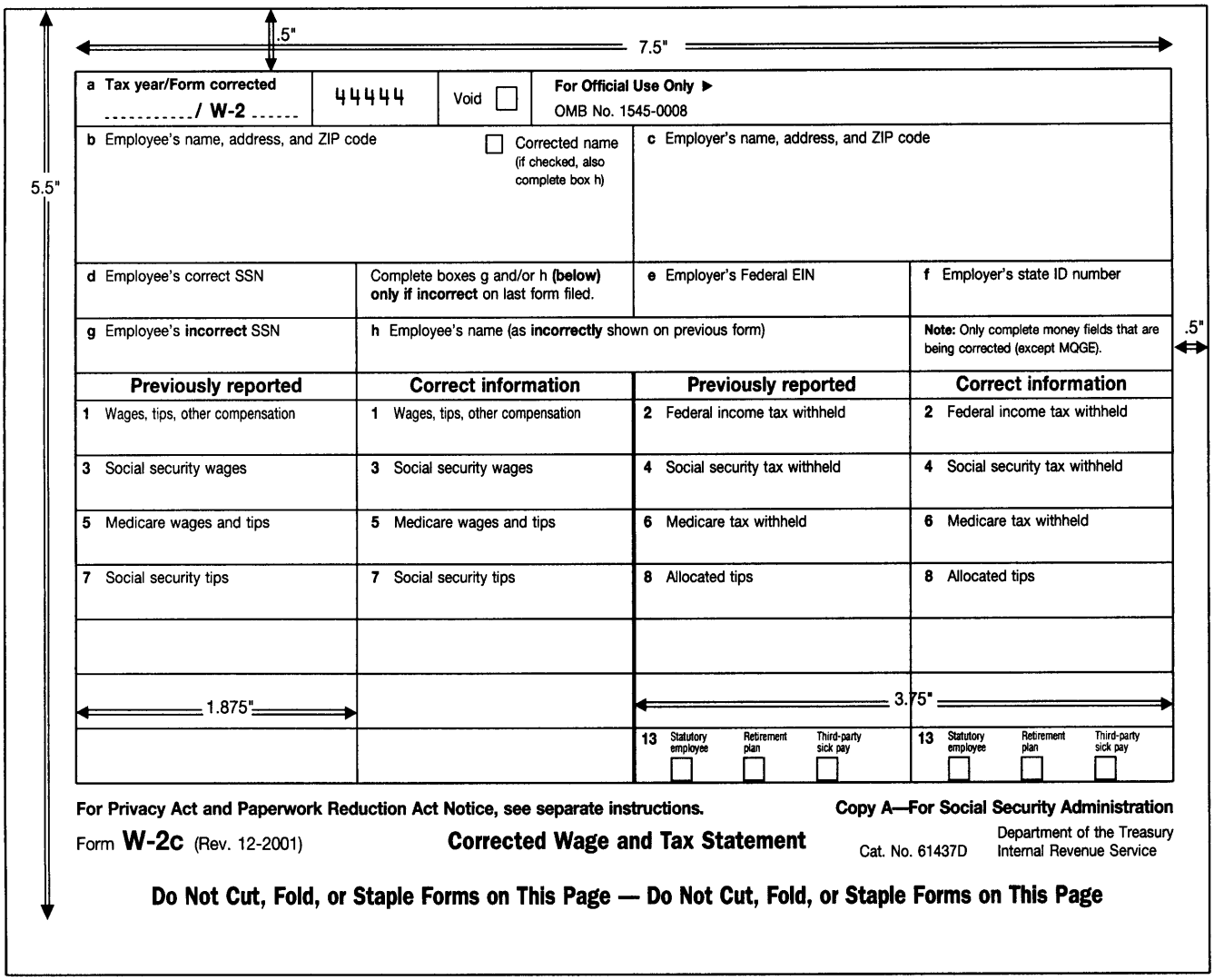
.03 The IRS also offers an alternative to downloading electronic files and provides current and prior-year access to tax forms and instructions through its federal tax forms CD-ROM. Order **Pub. 1796**, *IRS Federal Tax Products CD-ROM*, by using the IRS' Internet Website at **www.irs.gov/cdorders** or by calling 1–877–CDFORMS (1–877–233–6767).

Section 9 — Effect on Other Revenue Procedures

.01 Revenue Procedure 95–18, 1995–1 C.B. 657 (reprinted as Publication 1223, Rev 3–95), is superseded.

Section 10 — Exhibits

Exhibit A



.5"

7.5"

5.5"

a Tax year/Form corrected ----------/ W-2 ------	44444	Void ☐	For Official Use Only ▶ OMB No. 1545-0008
b Employee's name, address, and ZIP code ☐ Corrected name (if checked, also complete box h)			c Employer's name, address, and ZIP code
d Employee's correct SSN	Complete boxes g and/or h **(below) only if incorrect** on last form filed.		e Employer's Federal EIN / f Employer's state ID number
g Employee's **incorrect** SSN	h Employee's name (as **incorrectly** shown on previous form)		**Note:** Only complete money fields that are being corrected (except MQGE). .5"

Previously reported	Correct information	Previously reported	Correct information
1 Wages, tips, other compensation	1 Wages, tips, other compensation	2 Federal income tax withheld	2 Federal income tax withheld
3 Social security wages	3 Social security wages	4 Social security tax withheld	4 Social security tax withheld
5 Medicare wages and tips	5 Medicare wages and tips	6 Medicare tax withheld	6 Medicare tax withheld
7 Social security tips	7 Social security tips	8 Allocated tips	8 Allocated tips
1.875"		3.75"	
		13 Statutory employee ☐ Retirement plan ☐ Third-party sick pay ☐	13 Statutory employee ☐ Retirement plan ☐ Third-party sick pay ☐

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. **Copy A—For Social Security Administration**

Form **W-2c** (Rev. 12-2001) **Corrected Wage and Tax Statement** Cat. No. 61437D Department of the Treasury Internal Revenue Service

Do Not Cut, Fold, or Staple Forms on This Page — Do Not Cut, Fold, or Staple Forms on This Page

Exhibit B

.5" 7.5"

a Tax year/Form corrected ---------- / W--------	55555	For Official Use Only ► OMB No. 1545-0008	
b Employer's name, address, and ZIP code		c Kind of Payer ▶ 941/941-SS ☐ Military ☐ 943 ☐ Sec. 218 ☐ CT-1 ☐ Hshld. emp. ☐ Medicare govt. emp. ☐ Third-party sick pay ☐	
d Number of Forms W-2c	e Employer's Federal EIN	f Establishment number	g Employer's state ID number
Complete boxes h, i, or j **only** if incorrect on last form filed.	h Employer's **incorrect** Federal EIN	i **Incorrect** establishment number	j Employer's **incorrect** state ID number
Total of amounts previously reported as shown on enclosed Forms W-2c.	**Total of corrected amounts as shown on enclosed Forms W-2c.**	**Total of amounts previously reported as shown on enclosed Forms W-2c.**	**Total of corrected amounts as shown on enclosed Forms W-2c.**
1 Wages, tips, other compensation	1 Wages, tips, other compensation	2 Federal income tax withheld	2 Federal income tax withheld
3 Social security wages	3 Social security wages	4 Social security tax withheld	4 Social security tax withheld
5 Medicare wages and tips	5 Medicare wages and tips	6 Medicare tax withheld	6 Medicare tax withheld
7 Social security tips	7 Social security tips	8 Allocated tips	8 Allocated tips
9 Advance EIC payments	9 Advance EIC payments	10 Dependent care benefits	10 Dependent care benefits
11 Nonqualified plans	11 Nonqualified plans	**12a-d** (Coded items)	**12a-d** (Coded items)
16 State wages, tips, etc.	16 State wages, tips, etc.	17 State income tax	17 State income tax
18 Local wages, tips, etc.	18 Local wages, tips, etc.	19 Local income tax	19 Local income tax
	1.875"	3.75"	

.5" .5"

Explain decreases here:

Has an adjustment been made on a employment tax return filed with the Internal Revenue Service? ☐ Yes ☐ No

If "Yes," give date the return was filed ▶

Under penalties of perjury, I declare that I have examined this return, including accompanying documents, and, to the best of my knowledge and belief, it is true, correct, and complete.

Signature ▶ Title ▶ Date ▶

Contact person	Telephone number ( )	For Official Use Only
E-mail address	Fax number ( )	

Changes To Note

Scannable Forms W-2c and W-3c. Forms W-2c and W-3c have been reformatted to allow scanning of paper forms by machine (optical character recognition equipment). Copy A of Form W-2c and Form W-3c must be printed on 8.5-inch by 11-inch paper using their revised formats and nonreflective black ink.

Prior year corrections. The box numbers (1-19) shown above relate to box labels on the 2001 Form W-2. If you are correcting a Form W-2 for a year prior to 2001, report the old box number shown on the incorrect Form W-2 on Form W-2c, but show the new box number on Form W-3c. For example, if you are correcting an entry in box 13 for a 2000 Form W-2, label one of the empty boxes on Form W-2c as "13—Codes" and enter the original and corrected amounts and their codes. However, on Form W-3c, enter those totals in box "12a-d (Coded items)."

Where To File

If you use the U.S. Postal Service, send Forms W-2c and W-3c to the following address:

Social Security Administration
Data Operations Center
P.O. Box 3333
Wilkes-Barre, PA 18767-3333

If you use a carrier other than the U.S. Postal Service, send Forms W-2c and W-3c to the following address:

Social Security Administration
Data Operations Center
Attn: W-2c Process
1150 E. Mountain Drive
Wilkes-Barre, PA 18702-7997

Form **W-3c** (Rev. 12-2001) **Transmittal of Corrected Wage and Tax Statements** **DO NOT CUT, FOLD, OR STAPLE**

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 10164R

Department of the Treasury Internal Revenue Service

Printed on recycled paper

Part IV. Items of General Interest

Golden Parachute Payments; Correction

Announcement 2002–65

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains corrections to a notice of proposed rulemaking and notice of public hearing (REG–109114–90, 2002–9 I.R.B. 576) that was published in the **Federal Register** on Wednesday, February 20, 2002 (67 FR 7630) that will clarify the application of section 280G of the Internal Revenue Code to deny a deduction to a corporation for any excess parachute.

FOR FURTHER INFORMATION CONTACT: Erinn Madden at (202) 622–6060 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking and notice of public hearing that is the subject of these corrections are under section 280G of the Internal Revenue Code.

Need for Correction

As published, the notice of proposed rulemaking and notice of public hearing (REG–209114–90, 2002–9 I.R.B. 576) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the notice of proposed rulemaking and notice of public hearing (REG–209114–90), which is the subject of FR Doc. 02–3819, is corrected as follows:

1. On page 7630, column 1, in the preamble under the caption "SUMMARY:", fourth line from the bottom of the paragraph, the language "may rely on the 1989 regulations for any" is corrected to read "may rely on the 1989 proposed regulations for any".

2. On page 7630, column 2, in the preamble under the caption "FOR FURTHER INFORMATION CONTACT:", line 2, the language "Madden at (202) 622–6030 (not a toll" is corrected to read "Madden at (202) 622–6060 (not at toll-".

3. On page 7630, column 2, in the preamble under the paragraph heading "Background", second paragraph, line 9, the language "section 312(v)(2)(A), which relates to" is corrected to read "section 3121(v)(2)(A), which relates to the."

4. On page 7630, column 2, in the preamble under the paragraph heading "Background", second paragraph, line 14, the language "FR 19390 on May 5, 1989 (the 1989" is corrected to read "FR 19390 on May 5, 1989 and corrected in 54 FR 25879 (June 20, 1989) (the 1989".

5. On page 7631, column 1, in the preamble under the paragraph heading "*Disqualified Individuals*", second paragraph, line 7, the language "1989 regulations provides a *de minimis*" is corrected to read "1989 proposed regulations provides a *de minimis*".

6. On page 7634, column 2, in the preamble under the paragraph heading "*Reasonable Compensation*", first full paragraph from the top of the column, line 2 from end of paragraph, the language "show to be reasonable compensation" is corrected to read "shown to be reasonable compensation".

7. On page 7635, column 3, in the preamble under the paragraph heading "*Timing of the Payment of Tax under Section 4999*", paragraph 1, line 2, the language "section 312(v) and § 1.3121(v)–1(e)(4)" is corrected to read "section 3121(v) and § 31.3121(v)(2)–1(e)(4)".

8. On page 7635, column 3, in the preamble under the paragraph heading "*Proposed Effective Date*", line 4, the language "control occurring on or after January 1," is corrected to read "control that occurs on or after January 1,".

§ 1.280G–1 [Corrected]

9. On page 7638, column 2, § 1.280G–1, paragraph (g) of A–6:, *Example 4.*, line 10, the language "application of the exemption described in" is corrected to read "application of the exemption described in".

10. On page 7638, column 2, § 1.280G–1, paragraph (g) of A–6:, *Example 5.*, line 9, the language "pays or accrues a payment that would" is corrected to read "that would".

11. On page 7638, column 3, § 1.280G–1, paragraph (b)(1) of A–7:, line 9, the language "A–7, the vote can be no less than the" is corrected to read "A–7, the vote can be on less than the".

12. On page 7640, column 1, § 1.280G–1, paragraph (e) of A–7:, *Example 7.*, line 16, the language "the payments of $400,000 to X; $600,000 to" is corrected to read "and describing the payments of $400,000 to X; $600,000 to".

13. On page 7640, column 1, § 1.280G–1, paragraph (e) of A–7:, *Example 8.*, line 8, the language "the nature of the payments to X, Y, and Z are" is corrected to read "the nature and amount of the payments to X, Y, and Z are".

14. On page 7641, column 1, § 1.280G–1, paragraph (c) of A–11:, lines 18 and 19 from the top of the column, the language "under section 3121(v) and § 1.312(v)–1(c)(4) or payment related to health" is corrected to read "under section 3121(v) and § 31.3121(v)(2)–1(e)(4) of this chapter, or a payment related to health".

15. On page 7641, column 2, § 1.280G–1, paragraph (a) of A–13:, lines 13 and 14, the language "value of an option with an ascertainable fair market value at the time the option" is corrected to read "value of an option at the time the option".

16. On page 7642, column 1, § 1.280G–1, Q–17:, line 3, the language "purposes of paragraph (a)(1) of Q/A–15" is corrected to read "purposes of paragraph (a)(1) and (b) of Q/A–15".

17. On page 7642, column 3, § 1.280G–1, paragraph (c) of A–18:, line 16, the language "defined in Q/A–20 of this section). If the" is corrected to read "defined in Q/A–20 of this section). The number of employees is determined with regard to the rules in Q/A–19 (c). If the".

18. On page 7642, column 3, § 1.280G–1, paragraph (a) of A–19:, line 13, the language "A–21 of this section)

paid during the" is corrected to read "A–21 of this section) earned during the".

20. On page 7644, column 1, § 1.280G–1, paragraph (c) of A–22:, line 7, the language "that is closely associated and materially" is corrected to read "that is closely associated with and materially".

21. On page 7646, column 3, § 1.280G–1, paragraph (f) of A–24:, *Example 4.*, line 3 from the bottom of the column, the language "would been on January 15, 2011. The" is corrected to read "would have been on January 15, 2011. The".

22. On page 7648, column 1, § 1.280G–1, paragraph (c) of A–26:, line 13, the language "of section 129); or a no-additional-cost" is corrected to read "of section 129); a no-additional-cost".

23. On page 7648, column 1, § 1.280G–1, paragraph (c) of A–26:, line 15, the language "132(b)) or qualified employee discount" is corrected to read "132(b)) qualified employee discount".

24. On page 7648, column 1, § 1.280G–1, line 16, the language "(within the meaning of section 132(c));" is corrected to read "(within the meaning of section 132(c)) qualified retirement planning services under section 132(m);".

25. On page 7649, column 1, § 1.280G–1, paragraph (d) of A–27:, *Example 4.*, lines 11 through 22, the language "Corporation P shareholders also owned Corporation O stock (overlapping shareholders) with a fair market value of 5 percent of the value of Corporation O stock. The overlapping shareholders consist of Mutual Company A Growth Fund, which prior to the transaction owns 3 percent of the value of Corporation O stock, Mutual Company A Income Fund, which prior to the transaction owns 1 percent of the value of Corporation O stock, and B, an individual who prior to the transaction owns 1 percent" is corrected to read "Corporation O shareholders also owned Corporation P stock (overlapping shareholders) exchanged for O stock with a fair market value of 5 percent of the value of Corporation O stock. The overlapping shareholders consist of Mutual Company A Growth Fund, which prior to the transaction owns P stock that is exchanged for 3 percent of the value of Corporation O stock, Mutual Company A Income Fund, which prior to the transaction owns P stock that is exchanged for 1 percent of the value of Corporation O stock, and B an individual who prior to the transaction owns P stock that is exchanged for 1 percent"

26. On page 7651, column 1, § 1.280G–1, A–32:, line 12, the language "24 and 35 of this section. However, for" is corrected to read "24 and 31 of this section. However, for".

27. On page 7655, column 1, § 1.280G–1, paragraph (c) of A–42:, *Example 3.*, line 4, the language "services to Corporation N, when and if," is corrected to read "services to Corporation N, when and if".

28. On page 7656, column 2, § 1.280G–1, A–48: is corrected to read as follows:

§ 1.280G–1 Golden parachute payments.

* * * * *

A–48: This section applies to any payments that are contingent on a change in ownership or control that occurs on or after January 1, 2004. Taxpayers can rely on these rules after February 20, 2002, for the treatment of any parachute payment.

* * * * *

Cynthia E. Grigsby,
Chief, Regulations Unit,
Associate Chief Counsel
(Income Tax and Accounting).

(Filed by the Office of the Federal Register on June 20, 2002, 8:45 a.m., and published in the issue of the Federal Register for June 21, 2002, 67 F.R. 42210)

Foundations Status of Certain Organizations

Announcement 2002–66

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:

7-12 Model Aviation Youth Academy, Long Beach, CA
A-Home, Inc., New Orleans, LA
Acadian Memorial Foundation, Inc., St. Martinville, LA
Adventures in Art, Inc., Ft. Worth, TX
African-American Community Entrustment, San Francisco, CA
African American Portrait Collection, Inc., Sacramento, CA
Aha Mele 'O Ho 'Omau, Honolulu, HI
Alberta Street Apartments Preservation, Inc., Wilsonville, OR
Alianza Deministerios Evangelicos Nacionales, Costa Mesa, CA
Aloha Park Preservation, Inc., Wilsonville, OR
Alpha Community Housing Development, Inc., New Orleans, LA
Alpha Reading & Tutorial Services, Royal Palm Beach, FL
Alumni Basketball Camp, Inc., Norman, OK
Angels Anonymous of Horizon Hospice, Inc., Meridian, ID
Animal Welfare Council, Weatherford, TX
Arc Marion New Hope Foundation, Inc., Ocala, FL
Aromas San Juan Bautista Community Schools Foundation, San Juan Bautista, CA
Ascension Theatre, Inc., New York, NY
Autumn Glow Alzheimers Care Home, Inc., San Francisco, CA
Axumite Community Development Corporation, Stockton, CA
B. J. Hill and Associates, Inc., Fayetteville, NC
Babes and Tots Child Care, Inc., Mountain Home, AR
Backdoor Institute of Disability Enabling Resources & Services, Inc., Sacramento, CA
Baltimore County Health Council, Towson, MD
Barbour County Family Resource Network, Inc., Phillippi, WV
Barcap of Florida, Inc., Sarasota, FL

Beaufort County Cities in Schools, Inc., Hilton Head, SC
Behavioral Impact Counseling Services, Inc., Mission Hills, CA
Benedictus, El Cajon, CA
Bethel High School Band Boosters Club, Spanaway, WA
Bethlehem Partners in Prevention, Spartanburg, SC
Big Brothers Big Sisters of the Tulorosa Basin, Inc., Alamogordo, NM
Boston Islamic School, Inc., Boston, MA
Bound for Freedom, Inc., Charlotte, NC
Boys and Girls Club of Fauquier, Inc., Warrenton, VA
Boys & Girls Club of Lake County, Clearlake, CA
Brazos Valley Youth Corporation, College Station, TX
Brendas Full House, Columbia, MO
Brookhollow Tenant Association, Incorporation, Kerrville, TX
Business for Progress Economic Development Corporation, Hawaiian Gardens, CA
Butte Libraries Foundation, Chico, CA
Calabash Hawaii, Honolulu, HI
California Institute for Biodiversity, Walnut Creek, CA
Canine Service Corps, Wimberley, TX
Cantilever Network, Incorporated, Chicago, IL
Canyon Creek Narrow Guage Railway, Georgetown, CA
Caregivers Solutions, Inc., Oklahoma City, OK
Casper Storm AAU Basketball Club, Inc., Evansville, WY
Catholic Christian Community for Justice, Inc., Vallejo, CA
Center for Christian-Jewish Dialogue, Colorado Springs, CO
Center for Multicultural Wellness and Prevention, Inc., Winter Park, FL
Central California Arts Foundation, Tulare, CA
Central Coast Theater Works, Inc., Santa Cruz, CA
Central High Choral Booster Bunch, Inc., Phoenix, AZ
Central Valley Youth Services, Inc., Stockton, CA
Charles Apartments Housing Corporation, Gilroy, CA
Charleston Rotary Fund, Charleston, SC
Chesapeake Bay Educators, Weems, VA
Child Safety Net of Southern California, Los Angeles, CA
Children and Family Network, Inc., Silt, CO
Chillicothe Quarterback Club, Chillicothe, OH
Chinese Cultural Foundation of Diablo Valley, Danville, CA
Cleveland County Friends of the Fairgrounds, Inc., Norman, OK
Clover Hill Area Teen Center, Inc., Midlothian, VA
Coastal Health & Fitness, Inc., Camarillo, CA
Coleville High School PTSO, Coleville, CA
Collective Theatre Company, Winston Salem, NC
Colorado Inhalant Abuse Program, Inc., Denver, CO
Colquitt County Senior Consortium, Inc., Moultrie, GA
Columbus Metabolic Foundation, Inc., Columbus, GA
Communities in Schools of Asheville, Asheville, NC
Communities in Schools of the Valley of the Sun, Inc., Phoenix, AZ
Community Health Center of Glendale, Sylmar, CA
Community in Action, Inc., Gulfport, MS
Community Learning and Information Network of the Tri-State, Inc., Huntington, WV
Community Supporters of the Atlanta Symphony Orchestra, Atlanta, GA
Conejo Oaks Symphony, Inc., Thousand Oaks, CA
Connecticut Valley Soccer Club, Inc., Claremont, NH
Consortium for Learning & Research in Aging, Sacramento, CA
Contact Point Productions, Inc., Shelbyville, KY
Contemporary Asian Theatre Scene, San Jose, CA
Covenant Word Ministries, Inc., Dallas, TX
Coyote Trail PTF, Tucson, AZ
Crawford Center, Inc., Miami, FL
Crime Prevention Boosters, Nashville, TN
Crossroads Riding Center, Inc., Alexandria, LA
Cuarto Centennial Project Corporation, Albuquerque, NM
Cuban Cultural Group, Inc., Miami, FL
Cultural Movement, Inc., Goldsboro, NC
Cumberland Regional Improvement Corporation, Fayetteville, NC
Cypress and Senior Care Homes, Inc., Antioch, CA
Cypress Gardens Housing Corporation, Gilroy, CA
DARE Georgia, Inc., Decatur, GA
De Mano A Mano Spanish Language Hotline, Santa Barbara, CA
Decro Kappa Corporation, Anaheim Hills, CA
Deming Soccer League, Deming, NM
Desert Legacy Employment Solutions, Inc., Phoenix, AZ
Desoto County Domestic Violence Council, Arcadia, FL
Dwight R. Means Foundation, Dallas, TX
E. E. Brownell Academy of Humanities and Fine Arts Parents Club, Gilroy, CA
East Lincoln Middle School Parents-Teachers Organization, Iron Station, NC
Eden Economic Development Corporation, Eden, TX
Educational Concepts, Sacramento, CA
El Paisano Educational Resource Center, Inc., Albuquerque, NM
Ellenton Lions Foundation, Inc., Palmetto, FL
Ensemble Theatre, Scottsdale, AZ
Environmental Resourcing Association, Olympia, WA
Evansville Fc-Soccer League, Evansville, IN
F Q Story Block Watch Association, Phoenix, AZ
Fairmont Private Schools Parent Association, Anaheim, CA
Families for Children of Oregon, Portland, OR
Families for Inclusive Education, Jefferson, LA
Fannie Bush Teacher Organization of Winchester Kentucky, Winchester, KY
Fannin County High School Tip-Off Club, Inc., Mineral Bluff, GA
Few-Fund for Education Research and Training, Washington, DC
First Night Phoenix, Inc., Tempe, AZ
Five Forks Commemorative Committee, Prince George, VA
Florence County Association of Educational Office Professionals, Lake City, SC
Focus on Children, Inc., Durham, NC

Folsom St. Interchange, San Francisco, CA
For the Children, Mountain View, MO
Foundation for Students Education, Easton, MA
Fourth of July Celebration at Hansen Dam, Sun Valley, CA
Friends of Mallory Square, Inc., Key West, FL
Friends of Santa Clara Soccer Park, Santa Clara, CA
Friends of the Civic Arts Plaza, Thousand Oaks, CA
Friends of the Fairfax City Library, Fairfax, VA
Friends of the Ma Rainey Museum of the Blues, Inc., Columbus, GA
Friends of the National Kidney Association, San Francisco, CA
FSUS Sigma Chi Educational Foundation, Inc., Tallahassee, FL
Gardngs Favrp, Inc., Ft. Lauderdale, FL
Gate Parents Group of the San Mateo Union High School District, San Mateo, CA
Gateway Apprenticeship Program, Boulder, CO
Geneseo High School Soccer Boosters, Geneseo, IL
Georgia Community-Based Development, Inc., Atlanta, GA
Georgia Mountains Private Industry Council, Inc., Gainesville, GA
Get Well Soon Day Care Program, Aloha, OR
Glenoak Golden Eagel Kick Off Club, Inc., Canton, OH
Gods Kitchen, Inc., Boynton Beach, FL
Golden Starfish Buddy Program, Medina, WA
Golden Triangle Deacon & Deaconess Council, Beaumont, TX
Great American Museum of History, Carson City, NV
Group Opportunity, Inc., Richmond, CA
Gulf Shore Literary Society, Inc., Naples, FL
H & L Charities, Nashville, TN
Harbison West Elementary Parent Teacher Organization, Columbia, SC
Hawaii Power Builders, Inc., Honolulu, HI
Haywood County Agricultural & Activities Center Association, Waynesville, NC
Help-Out, Texas City, TX
Helper Intermountain Theatre, Helper, UT
High Peaks Educational Group, Inc., Boulder, CO
Highland Park Community Development Corporation, Pasadena, CA
Hilo Medical Center Foundation, Hilo, HI
Historic Entertainment and Repertory Organizational Society, Morrisville, NC
Hmong International Culture Reunion, Inc., Fresno, CA
Homebound Remembered, Inc., Lubbock, TX
Hope Connection, Mission Hills, CA
Housing Effort, Inc., Louisville, KY
Houston Enhanced Enterprise Community Governance Board, Houston, TX
Hub City Community Hospice, Compton, CA
Hui Kauhale, Inc., Honolulu, HI
Imani House, Winston Salem, NC
Inner City Youth, San Francisco, CA
Institute for Behavior and Research, Inc., Daphne, AL
Integrity Youth Enterprises, Inc., Santa Maria, CA
International Baccalaureate Foundation of Choctawhatchee H.S., Fort Walton, FL
Irby Adult Resources Center, Inc., Pascagoula, MS
Irene Cardenas Memorial Scholarship Fund, Del Rio, TX
J. W. Williams Neighborhood Center, Memphis, TN
Jeffco First Steps for Children With Special Needs, Golden, CO
JLWP Adult Day Care Center, Inc., Humphrey, AR
Juvenile Drug Diversion Program, Capitola, CA
Kami Educational Corporation, Fairbanks, AK
Keep the Kids Busy Foundation, Jackson, MS
Kent High Schools PTSA, Tacoma, WA
Kolours Dance, Inc., Atlanta, GA
Korean Artist Association of Southern California, Los Angeles, CA
La Cheim Psychological Treatment Services, Inc., Oakland, CA
La Joya Middle School PTC, Visalia, CA
Labor Museum & Learning Center of Michigan, Flint, MI
Lakers Premier Soccer Club, Inc., Mandeville, LA
Las Vegas Vecindario De Esperanza Resident Council, Las Vegas, NM
Latino American Economic Development Institute, Hollywood, CA
Latinos Unidos for Alcohol and Drug Services of Monterey County, Castroville, CA
Leland College Development Corporation, Baton Rouge, LA
Liberty Bells Group, Hopewell, VA
Life Care Institute, Inc., Boseman, MT
Life Net Ministries, Richmond, VA
Lincoln County Housing Coalition, Inc., Davenport, WA
Literacy Initiatives & Family Endeavors, San Antonio, TX
Living Classrooms of Florida, Inc., Riviera, FL
Los Molinos Educational Endowment Foundation, Los Molinos, CA
Louisiana Lacrosse Association, Shreveport, LA
Love Memorial Parent Teacher Organization, Lincolnton, NC
Lovell Wyoming Educational Foundation, Inc., Lovell, WY
Lower Umpqua Volunteers Luv, Inc., Reedsport, OR
Lyons Elementary Parent Teacher Organization, Lyons, CO
Marc Carr Evangelistic Association, Inc., Sarasota, FL
Marin People Care, San Rafael, CA
Maryland Parent Teacher Organization, Phoenix, AZ
Maui Tongan Association, Kahului, HI
McKendree Vilage Home Health, Inc., Hermitage, TN
MDC Today Foundation, Oklahoma City, OK
Mead High PTSA, Tacoma, WA
Men of Moral Consciousness, Wilson, NC
Merchants Development, Inc., Birmingham, AL
Mid-Ohio Community Information Network, Newark, OH
Mid-South Interventions & Solutions Institute, Inc., Natchitiches, LA
Middletown Educational Foundation, Middletown, CA
Miracles Recovery Center, Inc., Houston, TX

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 law 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 the 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.—Intemal 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.—Statements 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.

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[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2002–1 through 2002–25 is in Internal Revenue Bulletin 2002–26, dated July 1, 2002.