

TABLE—Continued
[In dollar amounts]

1	2	3	4	5	6	7
Years of service	Final average compensation	Benefit under plan formula (Column 2 × 0.9 × years of service/30)	Final pay	Employer-provided projected primary insurance amount under social security attributable to service for employer	Benefit if final pay reduction is applied in full (Column 4 – Column 5)	Benefit to which A is entitled (smaller of Column 6 or Column 3, but not less than Column 7 for prior year)
27	15,500	12,555	15,800	4,400	11,400	11,400
28	15,500	13,020	16,000	4,500	11,500	11,500
29	15,000	13,050	16,000	4,800	11,200	11,500
30	14,500	13,050	16,000	5,000	11,000	11,500

(f) *Certain benefits not taken into account.* In determining whether a plan satisfies section 401(a)(4) and this section, other benefits created under state or federal law (e.g., worker’s compensation benefits or black lung benefits) may not be taken into account.

(g) *More than one plan treated as single plan.* [Reserved]

(h) *Effective date—(1) In general.* Except as provided in paragraph (h)(2) of this section, this section is effective for plan years beginning on or after January 1, 1994.

(2) *Plans of tax-exempt organizations.* In the case of plans maintained by organizations exempt from income taxation under section 501(a), including plans subject to section 403(b)(12)(A)(i) (nonelective plans), this section is effective for plan years beginning on or after January 1, 1996.

(3) *Compliance during transition period.* For plan years beginning before the effective date of these regulations, as set forth in paragraphs (h)(1) and (h)(2) of this section, and on or after the first day of the first plan year to which the amendments made to section 401(a)(5) by section 1111(b) of the Tax Reform Act of 1986 (TRA '86) apply, a plan must be operated in accordance with a reasonable, good faith interpretation of section 401(a)(5), taking into account pre-existing guidance and the amendments made by TRA '86 to related provisions of the Code. Whether a plan is operated in accordance with a reasonable, good faith interpretation of section 401(a)(5) will generally be determined based on all of the relevant facts

and circumstances, including the extent to which an employer has resolved unclear issues in its favor. A plan will be deemed to be operated in accordance with a reasonable, good faith interpretation of section 401(a)(5) if it is operated in accordance with the terms of this section.

[T.D. 8359, 56 FR 47614, Sept. 19, 1991; 57 FR 10817, 10818, 10951, Mar. 31, 1992, as amended by T.D. 8486, 58 FR 46830, Sept. 3, 1993]

§ 1.401(a)(17)-1 Limitation on annual compensation.

(a) *Compensation limit requirement—(1) In general.* In order to be a qualified plan, a plan must satisfy section 401(a)(17). Section 401(a)(17) provides an annual compensation limit for each employee under a qualified plan. This limit applies to a qualified plan in two ways. First, a plan may not base allocations, in the case of a defined contribution plan, or benefit accruals, in the case of a defined benefit plan, on compensation in excess of the annual compensation limit. Second, the amount of an employee’s annual compensation that may be taken into account in applying certain specified nondiscrimination rules under the Internal Revenue Code is subject to the annual compensation limit. These two limitations are set forth in paragraphs (b) and (c) of this section, respectively. Paragraph (d) of this section provides the effective dates of section 401(a)(17), the amendments made by section 13212 of the Omnibus Budget Reconciliation Act of 1993 (OBRA '93), and this section. Paragraph (e) of this section provides

rules for determining post-effective-date accrued benefits under the fresh-start rules.

(2) *Annual compensation limit for plan years beginning before January 1, 1994.* For purposes of this section, for plan years beginning prior to the OBRA '93 effective date, annual compensation limit means \$200,000, adjusted as provided by the Commissioner. The amount of the annual compensation limit is adjusted at the same time and in the same manner as under section 415(d). The base period for the annual adjustment is the calendar quarter ending December 31, 1988, and the first adjustment is effective on January 1, 1990. Any increase in the annual compensation limit is effective as of January 1 of a calendar year and applies to any plan year beginning in that calendar year. In any plan year beginning prior to the OBRA '93 effective date, if compensation for any plan year beginning prior to the statutory effective date is used for determining allocations or benefit accruals, or when applying any nondiscrimination rule, then the annual compensation limit for the first plan year beginning on or after the statutory effective date (generally \$200,000) must be applied to compensation for that prior plan year.

(3) *Annual compensation limit for plan years beginning on or after January 1, 1994—(i) In general.* For purposes of this section, for plan years beginning on or after the OBRA '93 effective date, annual compensation limit means \$150,000, adjusted as provided by the Commissioner. The adjusted dollar amount of the annual compensation limit is determined by adjusting the \$150,000 amount for changes in the cost of living as provided in paragraph (a)(3)(ii) of this section and rounding this adjusted dollar amount as provided in paragraph (a)(3)(iii) of this section. Any increase in the annual compensation limit is effective as of January 1 of a calendar year and applies to any plan year beginning in that calendar year. For example, if a plan has a plan year beginning July 1, 1994, and ending June 30, 1995, the annual compensation limit in effect on January 1, 1994 (\$150,000), applies to the plan for the entire plan year.

(ii) *Cost of living adjustment.* The \$150,000 amount is adjusted for changes in the cost of living by the Commissioner at the same time and in the same manner as under section 415(d). The base period for the annual adjustment is the calendar quarter ending December 31, 1993.

(iii) *Rounding of adjusted compensation limit.* After the \$150,000, adjusted in accordance with paragraph (a)(3)(ii) of this section, exceeds the annual compensation limit for the prior calendar year by \$10,000 or more, the annual compensation limit will be increased by the amount of such excess, rounded down to the next lowest multiple of \$10,000.

(4) *Additional guidance.* The Commissioner may, in revenue rulings and procedures, notices, and other guidance, published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter), provide any additional guidance that may be necessary or appropriate concerning the annual limits on compensation under section 401(a)(17).

(b) *Plan limit on compensation—(1) General rule.* A plan does not satisfy section 401(a)(17) unless it provides that the compensation taken into account for any employee in determining plan allocations or benefit accruals for any plan year is limited to the annual compensation limit. For purposes of this rule, allocations and benefit accruals under a plan include all benefits provided under the plan, including ancillary benefits.

(2) *Plan-year-by-plan-year requirement.* For purposes of this paragraph (b), the limit in effect for the current plan year applies only to the compensation for that year that is taken into account in determining plan allocations or benefit accruals for the year. The compensation for any prior plan year taken into account in determining an employee's allocations or benefit accruals for the current plan year is subject to the applicable annual compensation limit in effect for that prior year. Thus, increases in the annual compensation limit apply only to compensation taken into account for the plan year in which the increase is effective. In addition, if compensation for any plan year

beginning prior to the OBRA '93 effective date is used for determining allocations or benefit accruals in a plan year beginning on or after the OBRA '93 effective date, then the annual compensation limit for that prior year is the annual compensation limit in effect for the first plan year beginning on or after the OBRA '93 effective date (generally \$150,000).

(3) *Application of limit to a plan year—*

(i) *In general.* For purposes of applying this paragraph (b), the annual compensation limit is applied to the compensation for the plan year on which allocations or benefit accruals are based.

(ii) *Compensation for the plan year.* If a plan determines compensation used in determining allocations or benefit accruals for a plan year based on compensation for the plan year, then the annual compensation limit that applies to the compensation for the plan year is the limit in effect for the calendar year in which the plan year begins. Alternatively, if a plan determines compensation used in determining allocations or benefit accruals for the plan year on the basis of compensation for a 12-consecutive-month period, or periods, ending no later than the last day of the plan year, then the annual compensation limit applies to compensation for each of those periods based on the annual compensation limit in effect for the respective calendar year in which each 12-month period begins.

(iii) *Compensation for a period of less than 12-months—(A) Proration required.* If compensation for a period of less than 12 months is used for a plan year, then the otherwise applicable annual compensation limit is reduced in the same proportion as the reduction in the 12-month period. For example, if a defined benefit plan provides that the accrual for each month in a plan year is separately determined based on the compensation for that month and the plan year accrual is the sum of the accruals for all months, then the annual compensation limit for each month is $\frac{1}{12}$ th of the annual compensation limit for the plan year. In addition, if the period for determining compensation used in calculating an employee's allocation or accrual for a plan year is a short plan year (i.e., shorter than 12

months), the annual compensation limit is an amount equal to the otherwise applicable annual compensation limit multiplied by a fraction, the numerator of which is the number of months in the short plan year, and the denominator of which is 12.

(B) *No proration required for participation for less than a full plan year.* Notwithstanding paragraph (b)(3)(iii)(A) of this section, a plan is not treated as using compensation for less than 12 months for a plan year merely because the plan formula provides that the allocation or accrual for each employee is based on compensation for the portion of the plan year during which the employee is a participant in the plan. In addition, no proration is required merely because an employee is covered under a plan for less than a full plan year, provided that allocations or benefit accruals are otherwise determined using compensation for a period of at least 12 months. Finally, notwithstanding paragraph (b)(3)(iii)(A) of this section, no proration is required merely because the amount of elective contributions (within the meaning of § 1.401(k)-1(g)(3)), matching contributions (within the meaning of § 1.401(m)-1(f)(12)), or employee contributions (within the meaning of § 1.401(m)-1(f)(6)) that is contributed for each pay period during a plan year is determined separately using compensation for that pay period.

(4) *Limits on multiple employer and multiemployer plans.* For purposes of this paragraph (b), in the case of a plan described in section 413(c) or 414(f) (a plan maintained by more than one employer), the annual compensation limit applies separately with respect to the compensation of an employee from each employer maintaining the plan instead of applying to the employee's total compensation from all employers maintaining the plan.

(5) *Family aggregation.* [Reserved]

(6) *Examples.* The following examples illustrate the rules in this paragraph (b).

Example 1. Plan X is a defined benefit plan with a calendar year plan year and bases benefits on the average of an employee's high 3 consecutive years' compensation. The OBRA '93 effective date for Plan X is January 1, 1994. Employee A's high 3 consecutive

years' compensation prior to the application of the annual compensation limits is \$160,000 (1994), \$155,000 (1993), and \$135,000 (1992). To satisfy this paragraph (b), Plan X cannot base plan benefits for Employee A in 1994 on compensation in excess of \$145,000 (the average of \$150,000 (A's 1994 compensation capped by the annual compensation limit), \$150,000 (A's 1993 compensation capped by the \$150,000 annual compensation limit applicable to all years before 1994), and \$135,000 (A's 1992 compensation capped by the \$150,000 annual compensation limit applicable to all years before 1994)). For purposes of determining the 1994 accrual, each year (1994, 1993, and 1992), not the average of the 3 years, is subject to the 1994 annual compensation limit of \$150,000.

Example 2. Assume the same facts as Example 1, except that Employee A's high 3 consecutive years' compensation prior to the application of the limits is \$185,000 (1997), \$175,000 (1996), and \$165,000 (1995). Assume that the annual compensation limit is first adjusted to \$160,000 for plan years beginning on or after January 1, 1997. Plan X cannot base plan benefits for Employee A in 1997 on compensation in excess of \$153,333 (the average of \$160,000 (A's 1997 compensation capped by the 1997 limit), \$150,000 (A's 1996 compensation capped by the 1996 limit), and \$150,000 (A's 1995 compensation capped by the 1995 limit)).

Example 3. Plan Y is a defined benefit plan that bases benefits on an employee's high consecutive 36 months of compensation ending within the plan year. Employee B's high 36 months are the period September 1995 to August 1998, in which Employee B earned \$50,000 in each month. Assume that the annual compensation limit is first adjusted to \$160,000 for plan years beginning on or after January 1, 1997. The annual compensation limit is \$150,000, \$150,000, and \$160,000 in 1995, 1996, and 1997, respectively. To satisfy this paragraph (b), Plan Y cannot base Employee B's plan benefits for the 1998 plan year on compensation in excess of \$153,333. This amount is determined by applying the applicable annual compensation limit to compensation for each of the three 12-consecutive-month periods. The September 1995 to August 1996 period is capped by the annual compensation limit of \$150,000 for 1995; the September 1996 to August 1997 period is capped by the annual compensation limit of \$150,000 for 1996; and the September 1997 to August 1998 period is capped by the annual compensation limit of \$160,000 for 1997. The average of these capped amounts is the annual compensation limit applicable in determining benefits for the 1998 year.

Example 4. (a) Employer P is a partnership. Employer P maintains Plan Z, a profit-sharing plan that provides for an annual allocation of employer contributions of 15 percent of plan year compensation for employees other than self-employed individuals, and

13.0435 percent of plan year compensation for self-employed individuals. The plan year of Plan Z is the calendar year. The OBRA '93 effective date for Plan Z is January 1, 1994. In order to satisfy section 401(a)(17), as amended by OBRA '93, the plan provides that, beginning with the 1994 plan year, the plan year compensation used in determining the allocation of employer contributions for each employee may not exceed the annual limit in effect for the plan year under OBRA '93. Plan Z defines compensation for self-employed individuals (employees within the meaning of section 401(c)(1)) as the self-employed individual's net profit from self-employment attributable to Employer P minus the amount of the self-employed individual's deduction under section 164(f) for one-half of self-employment taxes. Plan Z defines compensation for all other employees as wages within the meaning of section 3401(a). Employee C and Employee D are partners of Employer P and thus are self-employed individuals. Neither Employee C nor Employee D owns an interest in any other business or is a common-law employee in any business. For the 1994 calendar year, Employee C has net profit from self-employment of \$80,000, and Employee D has net profit from self-employment of \$175,000. The deduction for Employee C under section 164(f) for one-half of self-employment taxes is \$4,828. The deduction for Employee D under section 164(f) for one-half of self-employment taxes is \$6,101.

(b) The plan year compensation under the plan formula for Employee C is \$75,172 (\$80,000 minus \$4,828). The allocation of employer contributions under the plan allocation formula for 1994 for Employee C is \$9,805 (\$75,172 (Employee C's plan year compensation for 1994) multiplied by 13.0435%). The plan year compensation under the plan formula before application of the annual limit under section 401(a)(17) for Employee D is \$168,899 (\$175,000 minus \$6,101). After application of the annual limit, the plan year compensation for the 1994 plan year for Employee D is \$150,000 (the annual limit for 1994). Therefore, the allocation of employer contributions under the plan allocation formula for 1994 for Employee D is \$19,565 (\$150,000 (Employee D's plan year compensation after application of the annual limit for 1994) multiplied by 13.0435%).

Example 5. The facts are the same as in Example 4, except that Plan Z provides that plan year compensation for self-employed individuals is defined as earned income within the meaning of section 401(c)(2) attributable to Employer P. In addition, Plan Z provides for an annual allocation of employer contributions of 15 percent of plan year compensation for all employees in the plan, including self-employed individuals, such as Employees C and D. The net profit from self-employment for Employee C and the net profit from self-employment for Employee D

are the same as provided in *Example 4*. However, the earned income of Employee C determined in accordance with section 401(c)(2) is \$65,367 (\$80,000 minus \$4,828 minus \$9,805). The earned income of Employee D determined in accordance with section 401(c)(2) is \$146,869 (\$175,000 minus \$6,101 minus \$22,030). Therefore, the allocation of employer contributions under the plan allocation formula for 1994 for Employee C is \$9,805 (\$65,367 (Employee C's plan year compensation for 1994) multiplied by 15%). Employee D's earned income for 1994 does not exceed the 1994 annual limit of \$150,000. Therefore, the allocation of employer contributions under the plan allocation formula for 1994 for Employee D is \$22,030 (\$146,869 (Employee D's plan year compensation for 1994) multiplied by 15%).

(c) *Limit on compensation for nondiscrimination rules*—(1) *General rule*. The annual compensation limit applies for purposes of applying the nondiscrimination rules under sections 401(a)(4), 401(a)(5), 401(l), 401(k)(3), 401(m)(2), 403(b)(12), 404(a)(2) and 410(b)(2). The annual compensation limit also applies in determining whether an alternative method of determining compensation impermissibly discriminates under section 414(s)(3). Thus, for example, the annual compensation limit applies when determining a self-employed individual's total earned income that is used to determine the equivalent alternative compensation amount under § 1.414(s)-1(g)(1). This paragraph (c) provides rules for applying the annual compensation limit for these purposes. For purposes of this paragraph (c), compensation means the compensation used in applying the applicable nondiscrimination rule.

(2) *Plan-year-by-plan-year requirement*. For purposes of this paragraph (c), when applying an applicable nondiscrimination rule for a plan year, the compensation for each plan year taken into account is limited to the applicable annual compensation limit in effect for that year, and an employee's compensation for that plan year in excess of the limit is disregarded. Thus, if the nondiscrimination provision is applied on the basis of compensation determined over a period of more than one year (for example, average annual compensation), the annual compensation limit in effect for each of the plan years that is taken into account in determining the average applies to the

respective plan year's compensation. In addition, if compensation for any plan year beginning prior to the OBRA '93 effective date is used when applying any nondiscrimination rule in a plan year beginning on or after the OBRA '93 effective date, then the annual compensation limit for that prior year is the annual compensation limit for the first plan year beginning on or after the OBRA '93 effective date (generally \$150,000).

(3) *Plan-by-plan limit*. For purposes of this paragraph (c), the annual compensation limit applies separately to each plan (or group of plans treated as a single plan) of an employer for purposes of the applicable nondiscrimination requirement. For this purpose, the plans included in the testing group taken into account in determining whether the average benefit percentage test of § 1.410(b)-5 is satisfied are generally treated as a single plan.

(4) *Application of limit to a plan year*. The rules provided in paragraph (b)(3) of this section regarding the application of the limit to a plan year apply for purposes of this paragraph (c).

(5) *Limits on multiple employer and multiemployer plans*. The rule provided in paragraph (b)(4) of this section regarding the application of the limit to multiple employer and multiemployer plans applies for purposes of this paragraph (c).

(d) *Effective date*—(1) *Statutory effective date*—(i) *General rule*. Except as otherwise provided in this paragraph (d), section 401(a)(17) applies to a plan as of the first plan year beginning on or after January 1, 1989. For purposes of this section, statutory effective date generally means the first day of the first plan year that section 401(a)(17) is applicable to a plan. In the case of governmental plans, statutory effective date means the first day of the first plan year for which the plan is not deemed to satisfy section 401(a)(17) by reason of paragraph (d)(4) of this section.

(ii) *Exception for collectively bargained plans*. In the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified before March 1, 1986, section 401(a)(17) applies to allocations

and benefit accruals for plan years beginning on or after the earlier of—

(A) January 1, 1991; or

(B) The later of January 1, 1989, or the date on which the last of the collective bargaining agreements terminates (determined without regard to any extension or renegotiation of any agreement occurring after February 28, 1986). For purposes of this paragraph (d)(1)(ii), the rules of § 1.410(b)-10(a)(2) apply for purposes of determining whether a plan is maintained pursuant to one or more collective bargaining agreements, and any extension or renegotiation of a collective bargaining agreement, which extension or renegotiation is ratified after February 28, 1986, is to be disregarded in determining the date on which the agreement terminates.

(2) *OBRA '93 effective date*—(i) *In general*. For purposes of this section, OBRA '93 effective date means the first day of the first plan year beginning on or after January 1, 1994, except as provided in this paragraph (d)(2).

(ii) *Exception for collectively bargained plans*—(A) *In general*. In the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and 1 or more employers ratified before August 10, 1993, OBRA '93 effective date means the first day of the first plan year beginning on or after the earlier of—

(I) The latest of—

(i) January 1, 1994;

(ii) The date on which the last of such collective bargaining agreements terminates (without regard to any extension, amendment, or, modification of such agreements on or after August 10, 1993); or

(iii) In the case of a plan maintained pursuant to collective bargaining under the Railway Labor Act, the date of execution of an extension or replacement of the last of such collective bargaining agreements in effect on August 10, 1993; or

(2) January 1, 1997.

(B) *Determination of whether plan is collectively bargained*. For purposes of this paragraph (d)(2)(ii), the rules of § 1.410(b)-10(a)(2) apply for purposes of determining whether a plan is maintained pursuant to one or more collec-

tive bargaining agreements, except that August 10, 1993, is substituted for March 1, 1986, as the date before which the collective bargaining agreements must be ratified.

(3) *Regulatory effective date*. This § 1.401(a)(17)-1 applies to plan years beginning on or after the OBRA '93 effective date. However, in the case of a plan maintained by an organization that is exempt from income taxation under section 501(a), including plans subject to section 403(b)(12)(A)(i) (nonelective plans), this § 1.401(a)(17)-1 applies to plan years beginning on or after January 1, 1996. For plan years beginning before the effective date of these regulations and on or after the statutory effective date, a plan must be operated in accordance with a reasonable, good faith interpretation of section 401(a)(17), taking into account, if applicable, the OBRA '93 reduction to the annual compensation limit under section 401(a)(17).

(4) *Special rules for governmental plans*—(i) *Deemed satisfaction by governmental plans*. In the case of governmental plans described in section 414(d), including plans subject to section 403(b)(12)(A)(i) (nonelective plans), section 401(a)(17) is considered satisfied for plan years beginning before the later of January 1, 1996, or 90 days after the opening of the first legislative session beginning on or after January 1, 1996, of the governing body with authority to amend the plan, if that body does not meet continuously. For purposes of this paragraph (d)(4), the term governing body with authority to amend the plan means the legislature, board, commission, council, or other governing body with authority to amend the plan.

(ii) *Transition rule for governmental plans*—(A) *In general*. In the case of an eligible participant in a governmental plan (within the meaning of section 414(d)), the annual compensation limit under this section shall not apply to the extent that the application of the limitation would reduce the amount of compensation that is allowed to be taken into account under the plan below the amount that was allowed to be taken into account under the plan as in effect on July 1, 1993. Thus, for example, if a plan as in effect on July 1,

1993, determined benefits without any reference to a limit on compensation, then the annual compensation limit in effect under this section will not apply to any eligible participant in any future year.

(B) *Eligible participant.* For purposes of this paragraph (d)(4)(ii), an eligible participant is an individual who first became a participant in the plan prior to the first day of the first plan year beginning after the earlier of—

(1) The last day of the plan year by which a plan amendment to reflect the amendments made by section 13212 of OBRA '93 is both adopted and effective; or

(2) December 31, 1995.

(C) *Plan must be amended to incorporate limits.* This paragraph (d)(4)(ii) shall not apply to any eligible participant in a plan unless the plan is amended so that the plan incorporates by reference the annual compensation limit under section 401(a)(17), effective with respect to noneligible participants for plan years beginning after December 31, 1995 (or earlier, if the plan amendment so provides).

(5) *Benefits earned prior to effective date—(i) In general.* Allocations under a defined contribution plan or benefits accrued under a defined benefit plan for plan years beginning before the statutory effective date are not subject to the annual compensation limit. Allocations under a defined contribution plan or benefits accrued under a defined benefit plan for plan years beginning on or after the statutory effective date, but before the OBRA '93 effective date, are subject to the annual compensation limit under paragraph (a)(2) of this section. However, these allocations or accruals are not subject to the OBRA '93 reduction to the annual compensation limit described in paragraph (a)(3) of this section.

(ii) *Allocation for a plan year.* The allocations for a plan year include amounts described in § 1.401(a)(4)-2(c)(ii) or § 1.401(m)-1(f)(6) plus the earnings, expenses, gains, and losses attributable to those amounts.

(iii) *Benefits accrued for years before the effective date.* The benefits accrued for plan years prior to a specified date by any employee are the employee's benefits accrued under the plan, deter-

mined as if those benefits had been frozen (as defined in § 1.401(a)(4)-13(c)(3)(i)) as of the day immediately preceding such specified date. Thus, for example, benefits accrued for those plan years generally do not include any benefits accrued under an amendment increasing prior benefits that is adopted after the date on which the employee's benefits under the plan must be treated as frozen.

(e) *Determination of post-effective-date accrued benefits—(1) In general.* The plan formula that is used to determine the amount of allocations or benefit accruals for plan years beginning on or after the dates described in paragraph (d)(1) or (2) must comply with section 401(a)(17) as in effect on such date. This paragraph (e) provides rules for applying section 401(a)(17) in the case of section 401(a)(17) employees who accrue additional benefits under a defined benefit plan in a plan year beginning on or after the relevant effective date. Paragraph (e)(2) of this section contains definitions used in applying these rules. Paragraphs (e)(3) and (e)(4) of this section explain the application of the fresh-start rules in § 1.401(a)(4)-13 to the determination of the accrued benefits of section 401(a)(17) employees.

(2) *Definitions.* For purposes of this paragraph (e), the following definitions apply:

(i) *Section 401(a)(17) employee.* An employee is a section 401(a)(17) employee as of a date, on or after the statutory effective date, if the employee's current accrued benefit as of that date is based on compensation for a year prior to the statutory effective date that exceeded the annual compensation limit for the first plan year beginning on or after the statutory effective date. In addition, an employee is a section 401(a)(17) employee as of a date, on or after the OBRA '93 effective date, if the employee's current accrued benefit as of that date is based on compensation for a year prior to the OBRA '93 effective date that exceeded the annual compensation limit for the first plan year beginning on or after the OBRA '93 effective date. For this purpose, a current accrued benefit is not treated as based on compensation that exceeded the relevant annual compensation limit, if a plan makes a fresh start

using the formula with wear-away described in §1.401(a)(4)-13(c)(4)(ii), and the employee's accrued benefit determined under §1.401(a)(4)-13(c)(4)(ii)(B), taking into account the annual compensation limit, exceeds the employee's frozen accrued benefit (or, if applicable, the employee's adjusted accrued benefit) as of the fresh-start date.

(ii) *Section 401(a)(17) fresh-start date.* Section 401(a)(17) fresh-start date means a fresh-start date as defined in §1.401(a)(4)-12 not earlier than the last day of the last plan year beginning before the statutory effective date, and not later than the last day of the last plan year beginning before the effective date of these regulations.

(iii) *OBRA '93 fresh-start date.* OBRA '93 fresh-start date means a fresh-start date as defined in §1.401(a)(4)-12 not earlier than the last day of the last plan year beginning before the OBRA '93 effective date, and not later than the last day of the last plan year beginning before the effective date of these regulations.

(iv) *Section 401(a)(17) frozen accrued benefit.* Section 401(a)(17) frozen accrued benefit means the accrued benefit for any section 401(a)(17) employee frozen (as defined in §1.401(a)(4)-13(c)(3)(i)) as of the last day of the last plan year beginning before the statutory effective date.

(v) *OBRA '93 frozen accrued benefit.* OBRA '93 frozen accrued benefit means the accrued benefit for any section 401(a)(17) employee frozen (as defined in §1.401(a)(4)-13(c)(3)(i)) as of the OBRA '93 fresh-start date.

(3) *Application of fresh-start rules—(i) General rule.* In order to satisfy section 401(a)(17), a defined benefit plan must determine the accrued benefit of each section 401(a)(17) employee by applying the fresh-start rules in §1.401(a)(4)-13(c). The fresh-start rules must be applied using a section 401(a)(17) fresh-start date and using the plan benefit formula, after amendment to comply with section 401(a)(17) and this section, as the formula applicable to benefit accruals in the current plan year. In addition, the fresh-start rules must be applied to determine the accrued benefit of each section 401(a)(17) employee using an OBRA '93 fresh-start date and using the plan benefit formula, after

amendment to comply with the reduction in the section 401(a)(17) annual compensation limit described in paragraph (a)(3) of this section, as the formula applicable to benefit accruals in the current plan year.

(ii) *Consistency rules in §1.401(a)(4)-13(c) and (d)—(A) General rule.* In applying the fresh-start rules of §1.401(a)(4)-13(c) and (d), the group of section 401(a)(17) employees is a fresh-start group. See §1.401(a)(4)-13(c)(5)(ii)(A). Thus, the consistency rules of those sections govern, unless otherwise provided. For example, if the plan is using a fresh-start date applicable to all employees and is not adjusting frozen accrued benefits under §1.401(a)(4)-13(d) for employees who are not section 401(a)(17) employees, then the frozen accrued benefits for section 401(a)(17) employees may not be adjusted under §1.401(a)(4)-13(d) or this paragraph (e).

(B) *Determination of adjusted accrued benefit.* If the fresh-start rules of §1.401(a)(4)-13(c) and (d) are applied to determine the benefits of all employees after a fresh-start date, the plan will not fail to satisfy the consistency requirement of §1.401(a)(4)-13(c)(5)(i) merely because the plan makes the adjustment described in §1.401(a)(4)-13(d) to the frozen accrued benefits of employees who are not section 401(a)(17) employees, but does not make the adjustment to the frozen accrued benefits of section 401(a)(17) employees. In addition, the plan does not fail to satisfy the consistency requirement of §1.401(a)(4)-13(c)(5)(i) merely because the plan makes the adjustment described in §1.401(a)(4)-13(d) for section 401(a)(17) employees on the basis of the compensation formula that was used to determine the frozen accrued benefit (as required under paragraph (e)(4)(iii) of this section) but makes the adjustment for employees who are not section 401(a)(17) employees on the basis of any other method provided in §1.401(a)(4)-13(d)(8).

(4) *Permitted adjustments to frozen accrued benefit of section 401(a)(17) employees—(i) General rule.* Except as otherwise provided in paragraphs (e)(4)(ii) and (iii) of this section, the rules in §1.401(a)(4)-13(c)(3) (permitting certain adjustments to frozen accrued benefits)

apply to section 401(a)(17) frozen accrued benefits or OBRA '93 frozen accrued benefits.

(ii) *Optional forms of benefit.* After either the section 401(a)(17) fresh-start date or the OBRA '93 fresh-start date, a plan may be amended either to provide a new optional form of benefit or to make an optional form of benefit available with respect to the section 401(a)(17) frozen accrued benefit or the OBRA '93 frozen accrued benefit, provided that the optional form of benefit is not subsidized. Whether an optional form is subsidized may be determined using any reasonable actuarial assumptions.

(iii) *Adjusting section 401(a)(17) accrued benefits—(A) In general.* If the plan adjusts accrued benefits for employees under the rules of § 1.401(a)(4)-13(d) as of a fresh-start date, the adjusted accrued benefit (within the meaning of section § 1.401(a)(4)-13(d)) for each section 401(a)(17) employee must be determined after the fresh-start date by reference to the plan's compensation formula that was actually used to determine the frozen accrued benefit as of the fresh-start date. For this purpose, the plan's compensation formula incorporates the plan's underlying compensation definition and compensation averaging period. In making the adjustment, the denominator of the adjustment fraction described in § 1.401(a)(4)-13(d)(8)(i) is the employee's compensation as of the fresh-start date using the plan's compensation formula as of that date and, in the case of an OBRA '93 fresh-start date, reflecting the annual compensation limits that applied as of the fresh-start date. The numerator of the adjustment fraction is the employee's updated compensation (i.e., compensation for the current plan year within the meaning of § 1.401(a)(4)-13(d)(8)), determined after applying the annual compensation limits to each year's compensation that is used in the plan's compensation formula as of the fresh-start date. Similarly, in applying the alternative rule in § 1.401(a)(4)-13(d)(8)(v), the updated compensation that is substituted must be determined after applying the annual compensation limits to each year's compensation that is used in the plan's com-

ensation formula. Thus, no adjustment will be permitted unless the updated compensation (determined after applying the annual compensation limit) exceeds the compensation that was used to determine the employee's frozen accrued benefit.

(B) *Multiple fresh starts.* If a plan makes more than one fresh start with respect to a section 401(a)(17) employee, the employee's frozen accrued benefit as of the latest fresh-start date will either be determined by applying the current benefit formula to the employee's total years of service as of that fresh-start date or will consist of the sum of the employee's frozen accrued benefit (or adjusted accrued benefit (as defined in § 1.401(a)(4)-13(d)(8)(i))) as of the previous fresh-start date plus additional frozen accruals since the previous fresh start. If the frozen accrued benefit consists of such a sum, in making the adjustments described in paragraph (e)(4)(iii)(A) of this section, separate adjustments must be made to that previously frozen accrued benefit (or adjusted accrued benefit) and the additional frozen accruals to the extent that the frozen accrued benefit and the additional accruals have been determined using different compensation formulas or different compensation limits (i.e., the section 401(a)(17) limit before and after the reduction in limit described in paragraph (a)(3) of this section). In this case, if the plan is applying the adjustment fraction of § 1.401(a)(4)-13(d)(8)(i), the denominator of the separate adjustment fraction for adjusting each portion of the frozen accrued benefit must reflect the actual compensation formula, and, if applicable, compensation limit, originally used for determining that portion. For example, the frozen accrued benefit of a section 401(a)(17) employee as of the OBRA '93 fresh-start date may be based on the sum of the section 401(a)(17) frozen accrued benefit (determined without any annual compensation limit) plus benefit accruals in the years between the statutory effective date and the OBRA '93 effective date (based on compensation that was subject to the annual compensation limits for those years). In this example, in adjusting the section 401(a)(17) frozen accrued benefit,

the denominator of the adjustment fraction does not reflect any annual compensation limit. Similarly, in adjusting the frozen accruals for years between the statutory effective date and the OBRA '93 effective date, the denominator of the adjustment fraction reflects the level of the annual compensation limit in effect for those years.

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

Example 1. (a) Employer X maintains Plan Y, a calendar year defined benefit plan providing an annual benefit for each year of service equal to 2 percent of compensation averaged over an employee's high 3 consecutive calendar years' compensation. Section 401(a)(17) applies to Plan Y in 1989. As of the close of the last plan year beginning before January 1, 1989 (i.e., the 1988 plan year), Employee A, with 5 years of service, had accrued a benefit of \$25,000 which equals 10 percent (2 percent multiplied by 5 years of service) of average compensation of \$250,000. Employer X decides to comply with the provisions of this section for plan years before the effective date of this section. Employer X decides to make the amendment effective for plan years beginning on or after January 1, 1989, and uses December 31, 1988 as the section 401(a)(17) fresh-start date. Plan Y, as amended, provides that, in determining an employee's benefit, compensation taken into account is limited in accordance with the provisions of this section to the annual compensation limit under section 401(a)(17), and that, for section 401(a)(17) employees, the employee's accrued benefit is the greater of

(i) The employee's benefit under the plan's benefit formula (after the plan formula is amended to comply with section 401(a)(17)) as applied to the employee's total years of service; and

(ii) The employee's accrued benefit as of December 31, 1988, determined as though the employee terminated employment on that date without regard to any plan amendments after that date.

Employer X decides not to amend Plan Y to provide for the adjustments permitted under § 1.401(a)(4)-13(d) to the accrued benefit of section 401(a)(17) employees as of December 31, 1988.

(b) Under Plan Y, Employee A's accrued benefit at the end of 1989 is \$25,000, which is the greater of Employee A's accrued benefit as of the last day of the 1988 plan year (\$25,000), and \$24,000, which is Employee A's benefit based on the plan's benefit formula applied to Employee A's total years of service (\$200,000 multiplied by (2 percent multiplied by 6 years of service)). The formula of Plan Y applicable to section 401(a)(17) em-

ployees for calculating their accrued benefits for years after the section 401(a)(17) fresh-start date is the formula in § 1.401(a)-13(c)(4)(ii) (formula with wear-away). The fresh-start formula is applied using a benefit formula for the 1989 plan year that satisfies section 401(a)(17) and this section, and the December 31, 1988 fresh-start date used for the plan is a section 401(a)(17) fresh-start date within the meaning of paragraph (e)(2)(ii) of this section. Thus, Plan Y, as amended, satisfies paragraph (e)(3)(i) of this section for plan years commencing prior to the OBRA '93 effective date.

Example 2. Assume the same facts as in *Example 1*, except that the plan formula provides that effective January 1, 1989, for section 401(a)(17) employees, an employee's benefit will equal the sum of the employee's accrued benefit as of December 31, 1988 (determined as though the employee terminated employment on that date and without regard to any amendments after that date), and 2 percent of compensation averaged over an employee's high 3 consecutive years' compensation times years of service taking into account only years of service after December 31, 1988. Thus, under Plan Y's formula, Employee A's accrued benefit as of December 31, 1989 is \$29,000, which is equal to the sum of \$25,000 (Employee A's accrued benefit as of December 31, 1988) plus \$4,000 (\$200,000 multiplied by (2 percent multiplied by 1 year of service)). The formula of Plan Y applicable to section 401(a)(17) employees for calculating their accrued benefits for years after the section 401(a)(17) fresh-start date is the formula in § 1.401(a)-13(c)(4)(i) (formula without wear-away). The fresh-start formula is applied using a benefit formula for the 1989 plan year that satisfies section 401(a)(17) and this section, and the December 31, 1988 fresh-start date used for the plan is a section 401(a)(17) fresh-start date within the meaning of paragraph (e)(2)(ii) of this section. Thus, Plan Y, as amended, satisfies paragraph (e)(3)(i) of this section for plan years commencing prior to the OBRA '93 effective date.

Example 3. (a) Assume the same facts as in *Example 1*, except that the plan formula provides that effective January 1, 1989, an employee's benefit equals the greater of the plan formulas in *Example 1* and *Example 2*. The formula of Plan Y applicable to section 401(a)(17) employees for calculating their accrued benefits for years after the section 401(a)(17) fresh-start date is the formula in § 1.401(a)-13(c)(4)(iii) (formula with extended wear-away). The fresh-start formula is applied using a benefit formula for the 1989 plan year that satisfies section 401(a)(17) and this section, and the December 31, 1988 fresh-start date used for the plan is a section 401(a)(17) fresh-start date within the meaning of paragraph (e)(2)(ii) of this section. Thus, Plan Y, as amended, satisfies paragraph

(e)(3)(i) of this section for plan years commencing prior to the OBRA '93 effective date.

(b) Assume that for each of the years 1991-93 Employee A's annual compensation under the plan compensation formula, disregarding the amendment to comply with section 401(a)(17) is \$300,000. The annual compensation limit is adjusted to \$222,220, \$228,860, and \$235,840 for plan years beginning January 1, 1991, 1992, and 1993, respectively. Because Employer X has decided to amend Plan Y to comply with the provisions of this section effective for plan years beginning on or after January 1, 1989, and has used December 31, 1988 as the section 401(a)(17) fresh-start date, the compensation that may be taken into account for plan benefits in 1993 cannot exceed \$228,973 (the average of \$222,220, \$228,860, and \$235,840). Therefore, as of December 31, 1993, the benefit determined under the fresh-start formula with wear-away would be \$45,795 (\$228,973 multiplied by (2 percent multiplied by 10 years of service)). The benefit determined under the fresh-start formula without wear-away would be \$47,897, which is equal to \$25,000 (Employee A's section 401(a)(17) frozen accrued benefit) plus \$22,897 (\$228,973 multiplied by (2 percent multiplied by 5 years of service)). Because Employee A's accrued benefit is being determined using the fresh-start formula with extended wear-away, Employee A's accrued benefit as of December 31, 1993, is equal to \$47,897, the greater of the two amounts.

Example 4. (a) Assume the same facts as in *Example 3*, except that Plan Y satisfies § 1.401(a)(4)-13(d)(3) through (d)(7) and that the amendment to Plan Y effective for plan years beginning after December 31, 1988, also provided for adjustments to the section 401(a)(17) frozen accrued benefit in accordance with § 1.401(a)(4)-13(d) using the fraction described in § 1.401(a)(4)-13(d)(8)(i).

(b) As of December 31, 1993, the numerator of Employee A's compensation fraction is \$228,973 (the average of Employee A's annual compensation for 1991, 1992, and 1993, as limited by the respective annual limit for each of those years). The denominator of Employee A's compensation fraction determined in accordance with paragraph (e)(4)(iii) of this section is \$250,000 (the average of Employee A's high 3 consecutive calendar year compensation as of December 31, 1988, determined without regard to section 401(a)(17)). Therefore, Employee A's compensation fraction is $\frac{\$228,973}{\$250,000}$. Because the compensation adjustment fraction is less than 1, Employee A's section 401(a)(17) frozen accrued benefit is not adjusted. Therefore, Employee A's accrued benefit as of December 31, 1993, would still be \$47,897, which is equal to \$25,000 (Employee A's section 401(a)(17) frozen accrued benefit) plus \$22,897 (\$228,973 multiplied by (2 percent multiplied by 5 years of service)).

Example 5. (a) Assume the same facts as in *Example 3*, except that as of January 1, 1994, Plan Y is amended to provide that benefits will be determined based on compensation of \$150,000 (the limit in effect under section 401(a)(17) for plan years beginning on or after the OBRA '93 effective date) and that for section 401(a)(17) employees, each employee's accrued benefit will be determined under § 1.401(a)(4)-13(c)(4)(i) (formula without wear-away) using December 31, 1993 as the OBRA '93 fresh-start date.

(b) Assume that for each of the years 1996-98 Employee A's annual compensation under the plan compensation definition, disregarding the amendment to comply with section 401(a)(17), is \$400,000. Assume that the annual compensation limit is first adjusted to \$160,000 for plan years beginning on or after January 1, 1997, and is not adjusted for the plan year beginning on or after January 1, 1998. The compensation that may be taken into account for the 1998 plan year cannot exceed \$156,667 (the average of \$150,000 for 1996, \$160,000 for 1997, and \$160,000 for 1998).

(c) Therefore, at the end of December 31, 1998, Employee A's accrued benefit is \$63,564, which is equal to \$47,897 (Employee A's OBRA '93 frozen accrued benefit) plus \$15,667 (\$156,667 multiplied by (2 percent multiplied by 5 years of service)).

Example 6. (a) Assume the same facts as in *Example 5*, except that, for the fresh-start group (in this case the section 401(a)(17) employees), the amendments to Plan Y provide for adjustments to the section 401(a)(17) frozen accrued benefit and the OBRA '93 frozen accrued benefit in accordance with § 1.401(a)(4)-13(d) using the fraction described in § 1.401(a)(4)-13(d)(8)(i).

(b) Employee A's frozen accrued benefit as of December 31, 1993, is adjusted as of December 31, 1998, as follows:

(1) Employee A's frozen accrued benefit as of December 31, 1993, is the sum of Employee A's section 401(a)(17) frozen accrued benefit (\$25,000) and Employee A's frozen accruals for the years 1989-93 (\$22,897).

(2) The numerator of Employee A's adjustment fraction is \$156,667 (the average of \$150,000, \$160,000, and \$160,000). The denominator of Employee A's adjustment fraction with respect to Employee A's section 401(a)(17) frozen accrued benefit is \$250,000, and the denominator of Employee A's adjustment fraction with respect to the rest of Employee A's frozen accrued benefit is \$228,973 (the average of Employee A's annual compensation for 1991, 1992, and 1993, as limited by the respective annual limit for each of those years).

(3) Employee A's section 401(a)(17) frozen accrued benefit as adjusted through December 31, 1998, remains \$25,000. The compensation adjustment fraction determined in accordance with paragraph (e)(4)(iii) of this

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section is less than one (\$156,667 divided by \$250,000).

(4) Employee A's frozen accruals for the years 1989-93, as adjusted through December 31, 1998, remain \$22,897 because the adjustment fraction is less than one (\$156,667 divided by \$228,973).

(5) Employee A's adjusted accrued benefit as of December 31, 1998, equals \$47,897 (the sum of the \$25,000 and \$22,897 amounts from paragraphs (b)(3) and (b)(4), respectively, of this *Example*).

(c) Employee A's section 401(a)(17) frozen accrued benefit will not be adjusted for compensation increases until the numerator of the fraction used to adjust that frozen accrued benefit exceeds the denominator of \$250,000 used in determining those accruals.

Similarly, the portion of Employee A's OBRA '93 frozen accrued benefit attributable to the frozen accruals for the years 1989-1993 will not be adjusted for compensation increases until the numerator of the fraction used to adjust those frozen accruals exceeds the denominator of \$228,973 used in determining those accruals.

[T.D. 8547, 59 FR 32905, June 27, 1994]

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