CHAPTER 5--ISSUES RELATED TO THE REPEAL OF IRC SECTION 415(e)

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EMPLOYEE PLANS TECHNICALλ

INTERNAL REVENUE SERVICE
TAX EXEMPT AND GOVERNMENT ENTITIES

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INTRODUCTION

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the enactment of the Small Business Job Protection Act of 1996 ('SBJPA', Public Law 104-188, August 20, 1996) which repealed section 415(e), effective for limitation years beginning after December 31, 1999.

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

OBJECTIVES

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

1. Determine which participants are affected by the repeal of section 415(e), and the maximum benefit increase that can be provided under a plan upon the repeal of section 415(e);

2. Determine whether nondiscrimination tests are properly taking benefit increases due to the repeal of section 415(e) into account; and

3. Determine whether benefit increases due to the repeal of section 415(e) are funded properly under section 412.

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

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

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

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

DBF = participant's projected annual benefit (as of close of year)
lesser of 1.25 x DB dollar limit for year **or** 1.4 x DB compensation limit
(applicable to participant) (applicable to participant)

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

DCF = Sum of annual additions to participant's account (as of close of year)
sum of lesser of 1.25 x DC dollar limit **or** 1.4 x DC compensation
(for current year and for for year limit applicable to participant
each prior year of service

with employer)

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

II. IRC 415(e) LIMITATION FOR LIMITATION YEARS BEGINNING AFTER December 31, 1999

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

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

III. NOTICE 99-44

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

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

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

A. Plan Not Amended to Take Repeal of IRC 415(e) into Account.

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

Examples of methods that must be specified include:

(1) the method of determining compensation to be used for section 415 purposes; and

(2) the method under 1.415-6(b)(6) that will be used for the treatment of excess annual additions).

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

limits are no longer limited by section 415(e) and, in some cases, could automatically increase on the effective date of the repeal of section 415(e).

EXAMPLE 1—PLANS INCORPORATE SECTION 415 BY REFERENCE:

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

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

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

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

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

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

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

$$= 1/(5/4) = 0.8$$

Maximum DCF = 1.0 - 0.8 = 0.2

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

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

EXAMPLE 2—PLANS DO NOT INCORPORATE SECTION 415 BY REFERENCE

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

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

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

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

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

Thus, if a current or former employee accrues additional benefits under the plan that could have been accrued without regard to the repeal of section 415(e)

(including benefits that accrue as a result of a plan amendment) on or after the effective date of the repeal for the plan, then the current or former employee may receive a benefit arising from the repeal of section 415(e). Employers who want to give such benefit increases to employees or former employees who commenced benefits prior to the repeal of section 415(e) may have to provide additional benefits not related to the section 415(e) repeal first. Current or former employees who do not have accrued benefits under the plan on or after the effective date of the section 415(e) repeal for the plan cannot be provided benefit increases that reflect the repeal of section 415(e).

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

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

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

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

EXAMPLE 3—INCREASE IN ANNUITY TO RETIREE IN PAY STATUS:

Plan M Facts:

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

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

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

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

- Mortality is used in the pre-retirement period

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

Participant P Facts

- Participates in Plan M and in Plan N, a DC plan of same employer
- Commences receiving retirement benefits in the form of single life annuity January 1, 1996, at age 56
- Social Security Retirement Age (SSRA) = 66
- DCF at time of retirement is 0.36

- Compensation limit applicable to P at retirement was $150,000

- P's benefit under Plan M, before limitation for section 415 and payable at normal retirement age, is $145,000

DB DOLLAR LIMIT CALCULATION

The DB limit applicable to P is calculated below.

- 1996 dollar limit = $120,000 at SSRA

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

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

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

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

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

The $90,000 limitation at age 62 is reduced to age 56 using 6% and the applicable mortality table. (The following shows adjustment to the earlier age using interest and mortality, in which case the use of the "D" commutation functions is required.)

$$90{,}000 \times \frac{N_{62}^{(12)}}{} \times \frac{D_{62}}{\quad}$$

$$\frac{D_{62} \quad D_{56}}{\frac{N^{(12)}_{56}}{D_{56}}}$$

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

$$= 54{,}752$$

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

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

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

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

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

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

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

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

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

= 57,228

Alternatively, the value could be calculated

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

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

= 90,000 x 0.6359

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

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

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

SECTION 415(E) LIMIT CALCULATION

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

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

or DBF = 1.0 - 0.36 = 0.64

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

Written in fraction form:

$$0.64 = \frac{\text{P's maximum projected annual benefit}}{}$$

lesser of (1.25 x dollar limit applicable to P)
or (1.4 x compensation limit applicable to P)

= P's maximum projected annual benefit
lesser of (1.25 x 54,753) or (1.4 x 150,000)
68,441 210,000

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

or, equivalently,

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

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

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

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

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

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

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

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

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

Using the 2000 dollar limit of $135,000, the maximum annual benefit payable at age 56 is calculated as shown below. The dollar limit is calculated as before: first

adjusted to age 62 using the Notice 87-21 factors; and then adjusted actuarially to age 56 using the same methodology as previously shown.

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

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

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

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

b. Using the applicable mortality table and 5%

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

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

If Plan M had not provided that benefits for retirees (whose benefits had been limited (reduced) under section 415) are increased as adjustments are made under section 415(d), P's maximum annual benefit under Plan M would have remained at $43,802 for the years 1996 through 1999. However, if the plan was amended to provide for such increases effective for limitation years beginning January 1, 2000, P's benefit could be increased from $43,802 (the age 56 benefit limited in 1996 by sections 415(b) and 415(e), without adjustments for increases in the DB dollar limitation) to $61, 597 (the 2000 dollar limit reduced for commencement of benefits at age 56), plus the annual amount that is actuarially equivalent to the $9,128 that could have been paid in the prior limitation years had the plan provided for benefit increases to reflect the cost-of-living increases under section 415(d). The calculation of $9,128 is shown below.

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

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

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

EXAMPLE 4 – BENEFIT IN FORM OF 10 EQUAL INSTALLMENTS:

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

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

The adjustment for payment in 10 equal installments is shown below and

involves the use of a symbol to represent the present value of 10 beginning-of-period payments of $1 at 6% interest, read as "a angle 10, double dot, at 6%", and written as $\ddot{a}_{\overline{10}|6\%}$.

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

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

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

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

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

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

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

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

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

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

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

However, if Plan M was also amended to provide for cost-of-living adjustments under section 415(d), effective January 1, 2000, then P's remaining six installment payments could be increased by the actuarial equivalent (spread over six years) of the value of the increases in the single life annuity that would have been payable beginning on January 1, 2000 if P had elected a single life annuity (rather than the installment payments). That is, P's payments, effective January 1, 2000, could be increased by the actuarial equivalent of an annual benefit of $17,795 [which is equal to $61,597 (the 2000 dollar limitation, reduced for

commencement at age 56, but not limited by section 415(e)) minus $43,802 (the 1996 dollar limitation, reduced for commencement at age 56 and limited for satisfaction of section 415(e))], spread over six years. The calculation of the single-sum equivalent of an annual benefit of $17,795, beginning at age 60 (age in 2000), spread over 6 years at 6% is shown below.

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

Additionally, a second increase could be given. Plan M could provide that each of P's six remaining installment payments under Plan M are increased by the actuarial equivalent (spread over six years) of the value of the increases in the prior installment payments that would have been paid in the prior limitation years had the plan provided for increases in the installment payments to reflect increases under section 415(d). Earlier, we found that if Plan M had provided for COLA increases under section 415(d), and P's benefit had been paid in the form of single life annuity, P would have received an additional $9,128 for the years 1997 through 1999.

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

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

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

$$= 42{,}395$$

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

EXAMPLE 5 – SINGLE SUM DISTRIBUTION:

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

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

A's benefit was paid out in 1996 in the optional form of a single-sum distribution. According to Plan S's terms, single sums are computed using the applicable interest rate and the applicable mortality table. Participant A's 1996 single-sum distribution ($559,439) is calculated below, using the plan factors or the applicable interest rate of 6% and the applicable mortality table.

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

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

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

= 559,439/12.772
= 43,802

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

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

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

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

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

Participant A's age in 2000, which is 60. The maximum additional single sum benefit that could be provided to Participant A following the repeal of section 415(e) is calculated below, using 6% and the applicable mortality table.

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

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

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

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

B. Plan Amendment to Take Repeal of IRC 415(e) into Account.

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

Notice 99-44, in Q&A-7, provided that a plan could be amended to limit the extent to which a participant's benefit would otherwise automatically increase under the terms of the plan as a result of the repeal of section 415(e) (most likely as a result of the plan's incorporation of the section 415 limits by reference). Where a plan sponsor would like time to consider the extent to which a benefit increase relating to the repeal of section 415(e) might be provided at some later

date (which would be consistent with all relevant qualification requirements), the plan sponsor may make an amendment that precludes a benefit increase that would otherwise occur as a result of the repeal of section 415(e). However, a plan amendment to limit the extent to which a benefit increase would occur that is not both adopted prior to, and effective as of, the first day of the first limitation year beginning on or after January 1, 2000, may fail to satisfy section 411(d)(6).

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

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

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

EXAMPLE 6:

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

In 1999, Participant T’s accrued benefit under Plan A was reduced in order that a contribution for 1999 could be made on T’s behalf under Plan B. Prior to 2000,

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

EXAMPLE 7:

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

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

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

limits to be exceeded, the use of the rules in section 1.415-6(b)(6) would not be available. This is because the currently effective Code section 415 limitations are not exceeded, and the allocation of $750 in forfeitures does not constitute an excess annual addition.

C. SBJPA Amendment of IRC 415(c)(3).

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

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

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

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

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

D. Repeal of Section 415(e) and the Nondiscrimination Rules.

1. NONDISCRIMINATION IN AMOUNT-- SAFE HARBOR USED

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

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

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

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

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

2. NONDISCRIMINATION IN AMOUNT--GENERAL RULE USED

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

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

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

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

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

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

3. NONDISCRIMINATION IN AMOUNT--PLAN AMENDMENT AND FORMER EMPLOYEES

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

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

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

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

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

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

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

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

E. Other Provisions of Notice 99-44.

Funding

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

415(e) for the plan.

Old-law Benefits

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

Other Provisions In Notice 99-44

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

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

for the benefit of the employee was treated as a defined contribution plan of the employer.

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

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

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

(i) 50 employees of the employer, or

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

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

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

Regulation section 1.410(b)-3(a)(1) provides that a benefit increase is an increase in a benefit accrued or treated as an accrued benefit under section 411(d)(6). In determining whether there is an increase in a benefit accrued, the exception in regulation section 1.410(b)-3(a)(2)(ii)(a) must be taken into account,

which provides that plan provisions that implement the limits of Code section 415 are disregarded in determining whether an employee has a benefit increase. Specifically, any increases due to adjustments under section 415(d)(1) (automatic COLA adjustments), section 415(b)(5) (additional years of participation), or changes to the defined contribution fraction under section 415(e) are all disregarded, but only if such provision applies uniformly to all employees in the plan. Therefore, a benefit increase due to the repeal of section 415(e) generally is disregarded if the provision applies uniformly to all employees.

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

The memo states the following conclusions.

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

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

3. General test plans that take section 415 limits into account for nondiscrimination testing must be tested under regulation section 1.401(a)(26)-4 by treating benefit increases due to the repeal of section 415(e) as benefit increases for purposes of section

1.401(a)(26)-4. Benefit increases due to the repeal of section 415(e) cannot be ignored for this purpose, as the plan does not fit into the exception in section 1.410(b)-3(a)(2)(ii).

SUMMARY

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

Notice 99-44

Section 415 Limitations on Benefits and Contributions Under Qualified Plans

1999-2 C.B. 326; 1999 IRB LEXIS 304; 1999-35 I.R.B. 326; Notice 99-44

August 30, 1999

I. PURPOSE

This notice provides guidance relating to the repeal of the combined limitation on defined benefit and defined contribution plans under § 415(e) of the Internal Revenue Code (the Code) made by the Small Business Job Protection Act of 1996 (SBJPA), Pub. L. 104-88. In addition, this notice provides guidance on the amendment to the definition of compensation under § 415(c)(3) made by the same act. Specifically, this notice provides questions and answers on:

- Benefit increases that may be provided upon the repeal of § 415(e).
- Plan amendments that may be adopted to take into account the repeal of § 415(e).
- The treatment of the repeal of § 415(e) for purposes of applying the minimum funding standards under § 412.
- The effect of the repeal of § 415(e) and the modification of § 415(c)(3) on other qualification requirements.
- Relief under § 7805(b)(8) for certain plans that continue to use a definition of compensation under § 415(c)(3) as it existed prior to SBJPA.

II. BACKGROUND

Section 415 of the Code imposes limitations on contributions and benefits under qualified plans. Section 415(e) imposes limitations that apply to an individual who participates in both a defined benefit plan and a defined contribution plan maintained by the same employer. Section 1452(a) of SBJPA repealed § 415(e) of the Code, effective for limitation years beginning on or after January 1, 2000. The limitations of § 415(e) as in effect immediately prior to this effective date are referred to in this notice as the "pre-SBJPA § 415(e) limitations."

Section 415(c)(3) of the Code and the regulations thereunder provide a definition of compensation for purposes of computing the limitations on contributions and benefits for a participant in a qualified plan. Section 1434 of SBJPA amended § 415(c)(3) to include elective deferrals described in § 402(g)(3), and elective contributions to a § 125 cafeteria plan or a § 457(b) eligible deferred compensation plan, in a participant's compensation, effective for limitation years beginning on or after January 1, 1998.

Section 411(a) prescribes rules as to when an employee's right to his or her normal retirement benefit must become nonforfeitable under a qualified plan. Section 411(d)(6) generally prohibits a plan amendment, except for an amendment described in § 412(c)(8), that has the effect of decreasing a participant's accrued benefits under the plan.

Section 1106(h) of the Taxpayer Reform Act of 1986, Pub. L. 99-514, provides that notwithstanding any other provision of law, except as provided in regulations prescribed by the Secretary of the Treasury, a plan may incorporate by reference the limitations under § 415 of the Code. In Notice 87-21, 1987-1 C.B. 458, Q&A-11, the Service provided guidance for plans to incorporate by reference the limitations of § 415, for limitation years beginning on or after January 1, 1987.

Section 401(a)(4) prescribes nondiscrimination rules for qualified plans. Section 1.401(a)(4)-2 of the Income Tax Regulations imposes requirements relating to nondiscrimination in amount of employer contributions under a defined contribution plan. For this purpose, § 1.401(a)(4)-2(b) provides two safe harbor tests, and § 1.401(a)(4)-2(c) provides a general test. Plans that satisfy one of these safe harbors must provide for either a uniform allocation formula or a uniform points allocation formula as described in the regulation. Under § 1.401(a)(4)-2(b)(4)(iv), a safe-harbor plan does not fail to satisfy these uniformity requirements merely because the plan limits allocations otherwise provided under the allocation formula in accordance with the limitations of § 415.

Section 1.401(a)(4)-3 imposes requirements relating to nondiscrimination in amount of benefits under a defined benefit plan. For this purpose, § 1.401(a)(4)-3(b) provides for

several safe harbor tests, and § 1.401(a)(4)-3(c) provides a general test. To satisfy one of these safe harbors, a plan must provide for a uniform normal retirement benefit, uniform post-normal retirement benefit, and uniform subsidies. Under § 1.401(a)(4)-3(b)(6)(v), a safe-harbor plan does not fail to satisfy these uniformity requirements merely because the plan limits benefits otherwise provided under the benefit formula or accrual method in accordance with the limitations of § 415. Plans that satisfy the general test may do so by testing benefits with or without the application of the § 415 limitations.

Section 401(b) specifies a remedial amendment period during which a plan may be amended retroactively, under certain circumstances, to comply with the Code's qualification requirements. Pursuant to Rev. Proc. 99-23, 1999-16 I.R.B. 5, the remedial amendment period for plan amendments relating to recent legislation for most plans has been extended until the last day of the first plan year beginning on or after January 1, 2000. Section 4 of Rev. Proc. 99-23 provides that this remedial amendment period applies to plan amendments made to implement the repeal of § 415(e).

III. QUESTIONS AND ANSWERS

Q-1: WHAT IS THE EFFECTIVE DATE OF THE REPEAL OF § 415(E) OF THE CODE BY § 1452(A) OF SBJPA?

A-1: In accordance with § 1452(d)(1) of SBJPA, § 415(e) of the Code is repealed effective as of the first day of the first limitation year beginning on or after January 1, 2000. With respect to limitation years beginning on or after January 1, 2000, a defined contribution plan will not fail to satisfy § 415 solely because the annual additions for any participant for such years exceed the pre-SBJPA § 415(e) limitations. With respect to limitation years beginning on or after January 1, 2000, a defined benefit plan will not fail to satisfy § 415 solely because the plan provides that the benefit of any participant exceeds the pre-SBJPA § 415(e) limitations. Accordingly, the pre-SBJPA § 415(e) limitations will not limit the benefit of a participant in a defined benefit plan whose benefit has not commenced as of the first day of the first limitation year beginning on or after January 1, 2000. For rules regarding the application of the pre-SBJPA § 415(e) limitations to a participant in a defined benefit plan whose benefit has commenced as of that date, see Q&A-3 and 4.

Q-2: IF A PLAN IS NOT AMENDED TO TAKE INTO ACCOUNT THE REPEAL OF § 415(E), HOW MAY THE BENEFITS OF PLAN PARTICIPANTS BE AFFECTED?

A-2: If a plan is not amended to take into account the repeal of § 415(e), the effect on the benefits of plan participants will depend on the plan's existing provisions for applying the limitations of § 415(e) and any other relevant plan provisions. In some circumstances, a plan's existing provisions could result in automatic benefit increases for participants as of the effective date of the repeal of § 415(e) for the plan. For example, the repeal of § 415(e) could result in automatic benefit increases for participants in defined benefit plans that incorporate by reference the limitations under § 415. Similarly, the repeal of § 415(e) could result in automatic changes to annual additions for participants in defined contribution plans.

Q-3: MAY A DEFINED BENEFIT PLAN PROVIDE FOR BENEFIT INCREASES TO REFLECT THE REPEAL OF § 415(E) FOR A CURRENT OR FORMER EMPLOYEE WHO HAS COMMENCED BENEFITS UNDER THE PLAN PRIOR TO THE EFFECTIVE DATE OF THE REPEAL?

A-3: A defined benefit plan may provide for benefit increases to reflect the repeal of § 415(e) for a current or former employee who has commenced benefits under the plan prior to the effective date of the repeal of § 415(e) for the plan, but only if the employee or former employee is a participant in the plan on or after that effective date. For this purpose, an employee or former employee is a participant in the plan on a date if the employee or former employee has an accrued benefit (other than an accrued benefit resulting from a benefit increase that arises solely as a result of the repeal of § 415(e)) on that date. Thus, benefit increases to reflect the repeal of § 415(e) cannot be provided to current or former employees who do not have accrued benefits under the plan on or after the effective date of the repeal of § 415(e) for the plan. However, if a current or former employee accrues additional benefits under the plan that could have been accrued without regard to the repeal of § 415(e) (including benefits that accrue as a result of a plan amendment) on or after the effective date of the repeal of § 415(e) for the plan, then the current or former employee may receive a benefit arising from the repeal of § 415(e).

Q-4: HOW IS THE MAXIMUM PERMISSIBLE BENEFIT INCREASE CALCULATED FOR A CURRENT OR FORMER EMPLOYEE WHO HAS COMMENCED BENEFITS UNDER A DEFINED BENEFIT PLAN PRIOR TO THE EFFECTIVE DATE OF THE REPEAL OF § 415(E) FOR THE PLAN?

A-4: For any limitation year beginning on or after the effective date of the repeal of § 415(e) for the plan, the benefit payable to any current or former employee who has commenced benefits under the plan prior to that date in a form not subject to § 417(e)(3) may be increased to a benefit that is no greater than the benefit that would have been permitted for that year under § 415(b) for the employee had § 415(e) not limited the benefit at the time of commencement. Thus, the annual benefit for limitation years beginning on or after the effective date of the repeal of § 415(e) for the plan is

limited to the § 415(b) limitation for the employee (increased for cost-of-living-adjustments, if the plan provided for such adjustments) based on the employee's age at the time of commencement. In the case of a form of benefit that is subject to § 417(e)(3), the benefit payable for any limitation year beginning on or after the effective date of the repeal of § 415(e) for the plan may be increased by an amount that is actuarially equivalent to the amount of increase that could have been provided had the benefit been paid in the form of a straight life annuity. Whether or not the form of benefit is subject to § 417(e)(3), benefits attributable to limitation years beginning before January 1, 2000, cannot reflect benefit increases that could not be paid for those years because of § 415(e). In addition, any plan amendment to provide an increase as a result of the repeal of § 415(e) can be effective no earlier than the effective date of the repeal of § 415(e) for the plan. The following examples illustrate these principles:

EXAMPLE 1:

Plan M, a defined benefit plan, has a calendar plan year and limitation year. Plan M is not a top-heavy plan during any relevant period. Under Plan M, participants may elect to receive benefit distributions either in the form of an annuity or a single sum. Plan M provides that benefits for retirees are increased as the dollar limitation is indexed under § 415(d) of the Code. Plan M also provides that benefits will be limited to the extent necessary to satisfy the requirements of § 415(e). In order to reflect the § 417(e)(3) change made by GATT, Plan M was amended on January 1, 1995, effective as of that date, to substitute the applicable interest rate and the applicable mortality table for the original plan rate and the UP-1984 Mortality Table, respectively, to compute single-sum benefits under the plan. Additionally, Plan M was amended on July 1, 1998, effective as of January 1, 1995, to apply the § 415(b)(2)(E) changes made by GATT and SBJPA to all benefits under the plan on or after the RPA '94 § 415 effective date, as defined in Rev. Rul. 98-1, 1998-2 I.R.B. 5. Under Plan M, early retirement benefits and other optional forms of benefit are determined as the actuarial equivalents of a straight life annuity at normal retirement age using the applicable interest rate and applicable mortality table. For purposes of this example, the applicable interest rate for all relevant periods is assumed to be 6 percent.

P was a participant both in Plan M, and in Plan N, a defined contribution plan, before retiring at the end of 1995. P is unmarried and has a date of birth of January 1, 1940. P's social security retirement age is 66. P commenced receiving distributions from Plan M in the form of a single life annuity on January 1, 1996, at age 56. The dollar limitation of § 415(b)(1)(A) for 1996 was $ 120,000. P's compensation-based limit under § 415(b)(1)(B) was $ 150,000 for all relevant periods. Accordingly, the § 415(b) limitation for P's benefit in 1996 was $ 54,753 ($ 120,000 reduced for early retirement at age 56).

P's defined contribution fraction for 1996 was 0.36. Therefore, in order to comply with § 415(e) in the manner provided under the plan, P's benefit in Plan M was limited so that P's defined benefit fraction was equal to 0.64 (1 minus 0.36). Thus, P's benefit in 1996 was limited to $ 43,802 (0.64 multiplied by the lesser of (A) 1.25 multiplied by $ 54,753 or (B) 1.4 multiplied by $ 150,000).

The dollar limitation under § 415(b)(1)(A) increased to $ 125,000 in 1997, and to $ 130,000 in 1998 and 1999. In 1997, because of the indexing of the dollar limitation under Plan M, P's benefit was increased to $ 45,628. Similarly, in 1998, P's benefit was increased to $ 47,453. In 1999, because the dollar limitation was unchanged from 1998, P's benefit continued to be limited to $ 47,453. For purposes of this example, it is assumed that the § 415(b)(1)(A) dollar limitation will be $ 135,000 in 2000.

Effective January 1, 2000, P's annuity payments under Plan M are permitted to be increased to a maximum annuity benefit of $ 61,597 ($ 135,000 reduced for early retirement at age 56). However, no increase in P's benefit is permitted to reflect the difference between the limitation of § 415(b) and the limitation of § 415(e) in prior limitation years.

Alternatively, if Plan M had not provided that benefits for retirees are increased as the dollar limitation is indexed under § 415(d) of the Code, but was amended to provide for such increases effective for the limitation year beginning January 1, 2000, P's benefit could be increased from $ 43,802 (the benefit without adjustment for increases in the § 415(b)(1)(A) dollar limitation) to $ 61,597, plus the annual amount that is actuarially equivalent to the $ 9,128 that could have been paid in the prior limitation years ($ 1,826 for 1997, and $ 3,651 each for 1998 and 1999) had the plan provided for benefit increases to reflect the cost-of-living increases under § 415(d).

EXAMPLE 2:

Assume the same facts as in Example 1, except that Plan M does not provide that benefits for retirees are increased as the dollar limitation is indexed under § 415(d) of the Code, and P commenced distributions from Plan M in the form of ten equal annual installments commencing on January 1, 1996. Accordingly, the § 415(b) limitation for P's benefit in 1996 was $ 89,635 ($ 120,000 reduced for early retirement at age 56 and adjusted for the installment option). In order to comply with § 415(e), P's installment payment in 1996 was limited to $ 71,707. Similarly, for the years 1997 through 1999, P received installment payments of $ 71,707. As of January 1, 2000, P has six installment payments remaining. Because Plan M does not provide for cost-of-living adjustments under § 415(d), P's six remaining installment payments under Plan M are permitted to be increased, effective January 1, 2000, by the actuarial equivalent (spread over a period of six years) of the value of the increases in the single life annuity that would

have been payable beginning on January 1, 2000 (i.e., the increase from $ 43,802 to $ 54,753) if P had elected a single life annuity rather than the installment payment option.

If Plan M, however, was amended to provide for cost-of-living adjustments under § 415(d), effective January 1, 2000, then P's six remaining installment payments would be permitted to be increased by the actuarial equivalent (spread over a period of six years) of the value of the increases in the single life annuity that would have been payable beginning on January 1, 2000 (i.e., the increase from $ 43,802 to $ 61,597) if P had elected a single life annuity rather than the installment payment option. Furthermore, Plan M could provide that each of P's six remaining installment payments under Plan M are increased by the actuarial equivalent (spread over six years) of the value of the increases in the prior installment payment that would have been paid in the prior limitation years had the plan provided for increases in the installment payments to reflect the increases under § 415(d).

Q-5: HOW WILL A PLAN THAT TAKES INTO ACCOUNT THE REPEAL OF § 415(E) AS OF THE FIRST DAY OF THE FIRST LIMITATION YEAR BEGINNING ON OR AFTER JANUARY 1, 2000, SATISFY THE NONDISCRIMINATION IN AMOUNT OF BENEFITS REQUIREMENT?

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

For purposes of the general test for nondiscrimination in amount of contributions, increased contributions allocated under the terms of a defined contribution plan due to the repeal of § 415(e) must be taken into account in accordance with the rules of § 1.401(a)(4)-2(c)(2)(ii) for the plan year for which the increased allocations are made. For purposes of the general test for nondiscrimination in amount of benefits, increased benefits provided to an employee under the terms of a defined benefit plan due to the repeal of § 415(e) must be included as increases in the employee's accrued benefit (within the meaning of § 411(a)(7)(A)(i)) and the employee's most valuable optional form of payment of the accrued benefit (within the meaning of § 1.401(a)(4)-3(d)(1)(ii)) in accordance with the rules of § 1.401(a)(4)-3(d), and must be included in the computation of both the normal and most valuable accrual rates for any measurement period that includes the plan year for which the increase occurs. If the limitations of § 415 are taken into account in testing the plan for limitation years beginning on or after January 1, 2000, those limitations must reflect the repeal of § 415(e).

Q-6: IF BENEFIT INCREASES ARE PROVIDED TO EMPLOYEES AND FORMER EMPLOYEES UNDER A PLAN AS A RESULT OF THE REPEAL OF § 415(E), HOW ARE THE REQUIREMENTS OF §§

1.401(A)(4)-5 AND 1.401(A)(4)-10 OF THE REGULATIONS SATISFIED?

A-6: If benefit increases resulting from the repeal of § 415(e) are provided, as of the effective date of the repeal of § 415(e) for the plan, to either (1) all current and former employees who have an accrued benefit under the plan immediately before the effective date of the repeal of § 415(e) for the plan, or (2) all employees participating in the plan that have one hour of service after the effective date of the repeal of § 415(e) for the plan, through the adoption of a plan amendment, then the timing of such an amendment satisfies the requirements of § 1.401(a)(4)-5 of the regulations, and the requirements of § 1.401(a)(4)-10(b) of the regulations are satisfied. In addition, if benefit increases are provided, as of the effective date of the repeal of § 415(e) for the plan, to either of the two groups described in the preceding sentence through the operation of the plan's existing provisions, then the requirements of §§ 1.401(a)(4)-5 and 1.401(a)(4)-10(b) of the regulations are satisfied.

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

Q-7: MAY A PLAN BE AMENDED TO LIMIT THE EXTENT TO WHICH A PARTICIPANT'S BENEFIT WOULD OTHERWISE AUTOMATICALLY INCREASE UNDER THE TERMS OF THE PLAN AS A RESULT OF THE REPEAL OF § 415(E)?

A-7: Yes, a plan may be amended to limit the extent to which a participant's benefit would otherwise automatically increase under the terms of the plan as a result of the repeal of § 415(e). However, see Q&A-8 for certain qualification requirements that may be affected by such an amendment. A plan sponsor may wish to make a plan amendment to preclude a benefit increase that would otherwise occur as a result of the repeal of § 415(e) in order to provide time for the plan sponsor to consider the extent to which a benefit increase relating to the repeal of § 415(e) should or should not be provided at some later date consistent with all relevant qualification requirements. A plan amendment to limit the extent to which such a benefit increase would otherwise occur that is not both adopted prior to, and effective as of, the first day of the first limitation year beginning on or after January 1, 2000, may fail to satisfy § 411(d)(6). Therefore, a plan amendment that is intended to limit such a benefit increase should be both adopted prior to, and effective as of, the first day of the first limitation year

beginning on or after January 1, 2000 (even though the plan could be later amended during the plan's remedial amendment, at the option of the plan sponsor, to retroactively provide for the benefit increase). The following is an example of language that could be used by a plan sponsor, on an interim or permanent basis, in amending a defined benefit plan that would otherwise provide for a benefit increase due to the repeal of § 415(e), to retain the effect of the pre-SBJPA § 415(e) limitations in determining a participant's accrued benefit under the plan (without failing to satisfy § 411(d)(6)):

Effective as of the first day of the first limitation year beginning on or after January 1, 2000 (the "Effective Date"), and notwithstanding any other provision of the Plan, the accrued benefit for any participant shall be determined by applying the terms of the Plan implementing the limitations of § 415 as if the limitations of § 415 continued to include the limitations of § 415(e) as in effect on the day immediately prior to the Effective Date. For this purpose, the defined contribution fraction is set equal to the defined contribution fraction as of the day immediately prior to the Effective Date.

Q-8: ARE THERE QUALIFICATION REQUIREMENTS THAT MAY NOT BE SATISFIED IF A PLAN CONTINUES TO LIMIT BENEFITS AFTER THE FIRST DAY OF THE FIRST LIMITATION YEAR BEGINNING ON OR AFTER JANUARY 1, 2000, USING THE PRE-SBJPA § 415(E) LIMITATIONS?

A-8: There are some qualification requirements that may not be satisfied for a plan if the plan continues to limit benefits after the first day of the first limitation year beginning on or after January 1, 2000, using the pre-SBJPA § 415(e) limitations. Any exception from the otherwise applicable qualification rules that is permitted solely in order to satisfy the maximum limitations on contributions or benefits under § 415 with respect to a participant does not apply if the participant's contributions or benefits are below the limitations of § 415. Thus, such an exception is not permitted where a plan limits benefits in a manner that is more restrictive than required under § 415. For example, at any time on or after the first day of the first limitation year beginning on or after January 1, 2000, a qualified defined contribution plan could not provide that the provisions of § 1.415-6(b)(6) would be applied to place an amount that does not exceed the limitations under § 415, but that does exceed the pre-SBJPA § 415(e) limitations, in an unallocated suspense account as an excess annual addition. Similarly, a qualified cash or deferred arrangement could not provide that the provisions of § 1.415-6(b)(6)(iv) would be applied to permit the distribution of elective deferrals that do not exceed the limitations under § 415, but that exceed the pre-SBJPA § 415(e) limitations. See Q&A-10 for a description of the effects that the continued application of the pre-SBJPA § 415(e) limitations may have on the requirements for nondiscrimination testing. Additionally, if a participant's annual additions to a defined contribution plan result in a decrease in the participant's accrued benefit under a defined benefit plan (under the

terms of both plans), the relief previously provided under Q&A G-10 of Notice 83-10, 1983-1 C.B. 536 no longer applies, and such a reduction would violate § 411.

The qualification issues described in this Q&A-8 may arise whenever a lower limitation is applied under a plan in lieu of a statutory § 415 limitation that applies for the limitation year. For example, the issues described in this Q&A-8 may arise if a lower limitation is applied under a plan as a result of using a definition of compensation that is not within the meaning of § 415(c)(3), as amended by SBJPA. Q&A-9 provides § 7805(b)(8) relief that applies where a plan uses the pre-SBJPA § 415(c)(3) definition of compensation instead of the current § 415(c)(3) definition.

Q-9: TO THE EXTENT THAT A QUALIFIED DEFINED CONTRIBUTION PLAN APPLIES THE RULES IN § 1.415-6(B)(6) WITH RESPECT TO EXCESS ANNUAL ADDITIONS, MUST THE PLAN APPLY THE RULES IN § 1.415-6(B)(6) USING A DEFINITION OF COMPENSATION WITHIN THE MEANING OF § 415(C)(3) AS AMENDED BY SBJPA?

A-9: For limitation years ending on or after December 1, 1999, to the extent that a plan applies the rules in § 1.415-6(b)(6), a defined contribution plan will not satisfy the requirements of § 401(a) unless the rules of § 1.415-6(b)(6) are applied using a definition of compensation within the meaning of § 415(c)(3) as amended by SBJPA. However, for limitation years ending on or before November 30, 1999, pursuant to § 7805(b)(8), the Service will not treat a defined contribution plan as failing to satisfy the requirements of § 401(a) merely because the rules in § 1.415-6(b)(6) are applied using a definition of compensation within the meaning of § 415(c)(3) prior to its amendment by SBJPA.

Q-10: HOW MAY A PLAN THAT CONTINUES TO LIMIT BENEFITS AFTER THE FIRST DAY OF THE FIRST LIMITATION YEAR BEGINNING ON OR AFTER JANUARY 1, 2000, USING THE PRE-SBJPA § 415(E) LIMITATIONS, SATISFY THE NONDISCRIMINATION IN AMOUNT OF BENEFITS REQUIREMENT?

A-10: A plan does not fail to satisfy the uniformity requirements of §§ 1.401(a)(4)-2(b) or 1.401(a)(4)-3(b)(2) merely because the limitations under § 415 are taken into account under the safe harbor requirements. The continued application of the pre-SBJPA § 415(e) limitations for a plan year after the effective date of the repeal of § 415(e) for a plan would cause the plan to fail to satisfy the uniformity requirements for the otherwise applicable nondiscrimination in amount safe harbor. However, if a plan limits benefits at any time on or after the first day of the first limitation year beginning on or after January 1, 2000, using the pre-SBJPA § 415(e) limitations for highly compensated employees (but not for nonhighly compensated employees), the plan will not fail to satisfy the uniformity requirements and thus will not fail to satisfy a nondiscrimination in amount

safe harbor merely because of this limited application of the pre-SBJPA § 415(e) limitations. See §§ 1.401(a)(4)-2(b)(4)(v) and 1.401(a)(4)-3(b)(6)(x) of the regulations.

If a plan continues to limit benefits on or after the first day of the first limitation year beginning on or after January 1, 2000, using the pre-SBJPA § 415(e) limitations, the annual additions or accrued benefits that are taken into account in performing the general tests for nondiscrimination in amount of contributions or benefits must reflect the plan provisions that limit benefits in this manner.

Q-11: HOW IS THE REPEAL OF § 415(E) TREATED UNDER THE PLAN FOR PURPOSES OF § 412?

A-11: For purposes of § 412, any increase in the liabilities of a plan as a result of the repeal of § 415(e) must be treated as occurring pursuant to a plan amendment effective no earlier than the first day of the first limitation year beginning on or after January 1, 2000 (whether the increase in liabilities under the terms of the plan arises pursuant to a plan amendment, or pursuant to existing plan provisions, e.g., where benefits automatically increase as of the effective date of the repeal of § 415(e) for the plan). Accordingly, any amortization base that is established under § 412 for an increase in liabilities under a plan resulting from the repeal of § 415(e) must have an amortization period of 30 years. A plan amendment that makes the repeal of § 415(e) effective for a plan cannot be taken into account for purposes of § 412 prior to the effective date of the repeal of § 415(e) for the plan.

Q-12: WHAT IS THE EFFECT OF THE REPEAL OF § 415(E) ON AN "OLD-LAW BENEFIT" DEFINED IN Q&A-12 OF REV. RUL. 98-1, 1998-2 I.R.B. 5?

A-12: Under Q&A-13 of Rev. Rul. 98-1, a participant's old-law benefit under a plan is determined as of a specified freeze date that precedes the final implementation date for the plan. Under Q&A-15 of Rev. Rul. 98-1, a participant's old-law benefit cannot increase after the participant's freeze date. Under Q&A-12 of Rev. Rul. 98-1, the final implementation date for the plan cannot be later than the first day of the first limitation year beginning after December 31, 1999. Because the freeze date must precede the final implementation date, the latest possible freeze date under a plan is the day before the first day of the first limitation year beginning after December 31, 1999. Thus, the latest possible freeze date for a plan is the day before the effective date of the repeal of § 415(e) for the plan. As a result, the repeal of § 415(e) generally will have no effect on the amount of a participant's old-law benefit, as the old-law benefit would be determined prior to the effective date of the repeal of § 415(e) for the plan. Nevertheless, if the old-law benefit for a participant in a defined benefit plan was reduced during the period between the freeze date and the effective date of the repeal of § 415(e) for the plan because of annual additions credited to a participant's account in an existing defined

contribution plan, the old-law benefit may increase to the freeze-date level as of the effective date of the repeal of § 415(e) for the plan.

Q-13: ARE THE REQUIREMENTS OF § 415(B)(4)(B) AFFECTED BY THE REPEAL OF § 415(E)?

A-13: No. Section 415(b)(4)(B) generally provides that the limitation on benefits under a defined benefit plan under § 415(b) with respect to a participant cannot be less than $ 10,000, but only if the employer has not at any time maintained a defined contribution plan in which the participant participated. The statutory provision repealing § 415(e) did not modify § 415(b)(4)(B). Accordingly, the requirements of § 415(b)(4)(B) are unaffected by the repeal of § 415(e).

Q-14: HOW WILL THE REPEAL OF § 415(E) AFFECT THE REGULATIONS RELATING TO § 403(B)?

A-14: Under § 415(c)(4)(D) and the regulations regarding the exclusion allowance under § 403(b)(2), an employee may elect to have the provisions of § 415(c)(4)(C) apply for a taxable year. If the employee so elects, the employee's exclusion allowance is the maximum amount under § 415 that could be contributed by the employer for the benefit of the employee if the annuity contract for the benefit of the employee were treated as a defined contribution plan maintained by the employer. The fourth sentence of § 1.403(b)-1(d)(5) provides that the rules under § 415(e) apply where such an election is made. Section 1504(b) of the Taxpayer Relief Act of 1997, Pub. L. 105-34, provides that regulations regarding the exclusion allowance under § 403(b)(2) of the Code shall be modified to reflect the repeal of § 415(e). Accordingly, the Commissioner intends to modify the regulations such that the fourth sentence of § 1.403(b)-1(d)(5) does not apply after the effective date of the repeal of § 415(e).

IV. EFFECT ON OTHER DOCUMENTS

Notice 83-10 is modified.

V. DRAFTING INFORMATION

The principal author of this notice is Martin Pippins of the Employee Plans Division. For further information regarding this notice, contact the Employee Plans Division's taxpayer assistance number at (202) 622-6076 (not a toll-free number) between the hours of 2:30 p.m. and 3:30 p.m., Eastern Time, Monday through Thursday. Mr. Pippins' telephone number is (202) 622-7863 (also not a toll-free number).

Notice 99-55

26 CFR 601.602: Tax forms and instructions.

December 6, 1999

Limitations on Benefits and Contributions under Qualified Plans; Cost-of-Living Adjustments for 200016

Section 415 of the Internal Revenue Code (the Code) provides for dollar limitations on benefits and contributions under qualified retirement plans. Section 415 also requires that the Commissioner annually adjust these limits for cost-of-living increases. Other limitations applicable to deferred compensation plans are also affected by these adjustments.

Effective January 1, 2000, the limitation for the annual benefit under § 415(b)(1)(A) for a defined benefit plan is increased from $ 130,000 to $ 135,000. For participants who separated from service before January 1, 2000, the limitation for defined benefit plans under § 415(b)(1)(B) is computed by multiplying the participant's compensation limitation, as adjusted through 1999 by 1.0235. The limitation for defined contribution plans under § 415(c)(1)(A) remains unchanged at $ 30,000.

The Code provides that various other dollar amounts are to be adjusted at the same time and in the same manner as the dollar limitation of § 415(b)(1)(A) is adjusted. These dollar amounts and the adjusted amounts are as follows:

The limitation under § 402(g)(1) on the exclusion for elective deferrals described in § 402(g)(3) is increased from $ 10,000 to $ 10,500.

The dollar amount under § 409(o)(1)(C)(ii) for determining the maximum account balance in an employee stock ownership plan subject to a 5-year distribution period is increased from $ 735,000 to $ 755,000, while the dollar amount used to determine the lengthening of the 5-year distribution period is increased from $ 145,000 to $ 150,000.

The limitation used in the definition of a highly compensated employee under § 414(q)(1)(B) is increased from $ 80,000 to $ 85,000.

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16 Based on News Release IR-1999-80, dated October 19, 1999.

The annual compensation limit under §§ 401(a)(17) and 404(1) is increased from $ 160,000 to $ 170,000. The annual compensation limit under § 401(a)(17) for eligible participants in certain governmental plans that, under the plan as in effect on July 1, 1993, allowed cost-of-living adjustments to the compensation limitation under the plan under § 401(a)(17) to be taken into account, is increased from $ 270,000 to $ 275,000.

The compensation amount under § 408(k)(2)(C) regarding simplified employee pension plans (SEPs) is increased from $ 400 to $ 450. The compensation amount under § 408(k)(3)(C) for SEPs is increased from $ 160,000 to $ 170,000.

The limitation under § 408(p)(2)(A) regarding simple retirement accounts remains unchanged at $ 6,000.

The limitation on deferrals under § 457(b)(2) and (c)(1) concerning eligible deferred compensation plans of state and local governments and of tax-exempt organizations remains unchanged at $ 8,000.

The compensation amounts under § 1.61-21(f)(5)(i) and (iii) of the Income Tax Regulations concerning the definition of "control employee" for fringe benefit valuation purposes are increased from $ 70,000 and $ 145,000, respectively, to $ 75,000 and $ 150,000, respectively.

Administrators of defined benefit or defined contribution plans that have received favorable determination letters should not request new determination letters solely because of yearly amendments to adjust maximum limitations in the plans.