borrowing, the amount of the borrowing, the maturity date, if any, of the borrowing, and the interest rate on the borrowing;

(3) The security, if any, provided by the cash management program for repayment of deposits into the cash management program and the security required, if any, by the cash management program in support of borrowings from the program; and

(4) The daily balance of the cash management program.

(c) The oil pipeline company must maintain current and up-to-date copies of the documents authorizing the establishment of the cash management program including the following:

(1) The duties and responsibilities of the administrator and the other participants in the cash management program;

(2) The restrictions on deposits or borrowings by participants in the cash management program;

(3) The method used to determine the interest earning rates and interest borrowing rates for deposits into and borrowings from the program; and

(4) The method used to allocate interest income and expenses among the participants in the program.

* * * * *

PART 357—ANNUAL SPECIAL OR PERIODIC REPORTS: CARRIERS SUBJECT TO PART I OF THE INTERSTATE COMMERCE ACT

■ 11. The authority citation for part 357 continues to read:

Authority: 42 U.S.C. 7101–7352; 49 U.S.C. 60502; 49 App. U.S.C. 1–85 (1998).

■ 12. Section 357.5 is added to read as follows:

§ 357.5 Cash management programs and financial condition reports.

(a) Oil pipeline companies subject to the provisions of the Commission's Uniform System of Accounts in part 352 of this title that participate in cash management programs must file these agreements with the Commission. The documentation establishing the cash management program and entry into the program must be filed within 10 days of entry into the program. Subsequent changes to the cash management agreement must be filed with the Commission within 10 days of the change.

(b) Oil pipeline companies must determine, on a monthly basis within 15 days after the end of each month, the percentage of their capital structures that constitute proprietary capital. The proprietary capital ratio must be computed using a formula in which the total of the balances in the Proprietary Capital Accounts; Account 70, Capital stock, through Account 77, Accumulated other comprehensive income, in part 352 of this title, is the numerator and the total proprietary capital plus the total of the Long-Term Debt Accounts; Account 60, Long-term debt payable after one year, through Account 62, Unamortized discount and interest on long-term debt, in part 352 of this title, is the denominator.

(c) In the event that the proprietary capital ratio is less than 30 percent, the oil pipeline company must notify the Commission within 5 working days of the determination of that fact and must describe the significant event(s) or transaction(s) causing its proprietary capital ratio to be less than 30 percent including the extent to which the oil pipeline company has amounts loaned or money advanced to its parent, subsidiary, or affiliate companies through its cash management program(s), along with plans, if any, to regain at least a 30 percent proprietary capital ratio.

(d) In the event that the proprietary capital ratio subsequently meets or exceeds 30 percent, the carrier must notify the Commission within 5 days of the determination of that fact.

Note: This Appendix will not be published in the *Code of Federal Regulations.*

Appendix A—Commenters in RM02–14–000

Air Conditioning Contractors of America, *et al.* (late-filed).
Allegheny Energy, Inc., *et al.*
Ameren Corporation.
American Electric Power Company, Inc., *et al.*
American Public Gas Association.
Association of Oil Pipelines.
Avista Corporation.
California Public Utilities Commission (late-filed).
Chevron Pipeline Company, *et al.*
Cinergy Corp.
Dominion Resources, Inc.
Duke Energy Corporation.
Edison Electric Institute.
Edison Mission Energy and Edison Mission Marketing and Trading, Inc.
Electric Power Supply Association.
El Paso Energy Partners, L.P.
Entergy Services, Inc.
Exelon Corporation.
Fairfax Financial Holdings, Ltd. (late-filed).
FirstEnergy Corp.
Gulf South Pipeline Company, LP.
Interstate Natural Gas Association of America.
Kansas State Corporation Commission.
KeySpan Corporation.
The KM Pipelines.
Marathon Ashland Pipeline LLC.
Midwestern Gas Transmission Company.
Missouri Public Service Commission (late-filed).
National Fuel Gas Supply Corporation.
National Grid USA.
National Rural Electric Cooperative Association.
NiSource Inc.
Northeast Utilities.
Northern Natural Gas Company.
Ontario Energy Trading International.
PEPCO Holdings, Inc.
PG&E Corporation.
Philadelphia Gas Works.
Pinnacle West Companies.
Plains All American Pipeline, L.P.
Public Service Electric and Gas Company, *et al.*
SCANA Corporation.
TECO Power Services Corporation.
USG Pipeline Co, B–R Pipeline Co., and United States Gypsum Co.
Washington Utilities and Transportation Commission (late-filed).
WGL Holdings, Inc., Hampshire Gas Co., and Washington Gas Light Co.
Williston Basin Interstate Pipeline Company.
WPS Resources Corporation.

[FR Doc. 03–16819 Filed 7–7–03; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9072]

RIN 1545–BA24

Catch-Up Contributions for Individuals Age 50 or Older

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance concerning the requirements for retirement plans providing catch-up contributions to individuals age 50 or older pursuant to the provisions of section 414(v). These final regulations affect section 401(k) plans, section 408(p) SIMPLE IRA plans, section 408(k) simplified employee pensions, section 403(b) tax-sheltered annuity contracts, and section 457 eligible governmental plans, and affect participants eligible to make elective deferrals under these plans or contracts.

DATES: Effective Date: These final regulations are effective on July 8, 2003.

Applicability Date: These final regulations are applicable to contributions in taxable years beginning on or after January 1, 2004.

FOR FURTHER INFORMATION CONTACT: R. Lisa Mojiri-Azad or John T. Ricotta at 622–6060.

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR Part 1) under sections 402(g) and 414(v) of the Internal Revenue Code (Code). Section 414(v), added by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) (Public Law 107–16; 115 Stat. 38), effective for years beginning after December 31, 2001, permits an individual age 50 or older to make additional elective deferrals each year, up to a dollar limit, if certain requirements provided under that section are satisfied. Under section 414(v)(3), these additional elective deferrals are not subject to certain otherwise applicable limitations on elective deferrals and are excluded from consideration for certain nondiscrimination tests. Under section 414(v)(4), catch-up contributions generally must be made available to all catch-up eligible individuals who participate under any plan maintained by the employer that provides for elective deferrals.

Section 402(g)(1)(C) was added by the Job Creation and Worker Assistance Act of 2002, (JCWAA) (Public Law 107–147; 116 Stat. 21), effective for years beginning after December 31, 2001. This section increases the amount of elective deferrals that a catch-up eligible participant, as defined in section 414(v), may exclude from gross income under section 402(g) by the same dollar limit applicable for the year under section 414(v).

JCWAA also included technical corrections to section 414(v), including clarifications relating to: initial eligibility to make catch-up contributions, coordination of section 414(v) catch-up contributions for individuals who participate in more than one plan, coordination of section 414(v) catch-up contributions with the catch-up contributions provided under section 457(b)(3), and the application of the universal availability requirement of section 414(v)(4) in connection with mergers and acquisitions.

Proposed regulations under section 414(v) were published in the **Federal Register** on October 23, 2001 (66 FR 53555). On February 21, 2002, a public hearing was held on the proposed regulations. Notice 2002–4 (2002–1 C.B. 298) provided transitional rules for complying with the universal availability requirement of section 414(v)(4) and the proposed regulations.

After consideration of the comments and the changes made by JCWAA, these final regulations adopt the provisions of the proposed regulations with certain modifications, the most significant of which are highlighted below.

Explanation of Provisions

Under these final regulations, an applicable employer plan is not treated as violating any provision of the Code merely because the plan permits a catch-up eligible participant to make catch-up contributions. For this purpose, an applicable employer plan is a section 401(k) plan, a SIMPLE IRA plan (as defined in section 408(p)), a simplified employee pension (as defined in section 408(k)) (SEP), a plan or contract that satisfies the requirements of section 403(b), or a section 457 plan maintained by an eligible governmental employer (a section 457 eligible governmental plan).

Catch-up contributions are elective deferrals made by a catch-up eligible participant that exceed an otherwise applicable limit and that are treated as catch-up contributions under the plan, but only to the extent they do not exceed the maximum amount of catch-up contributions permitted for the taxable year. An employer is not required to provide for catch-up contributions in any of its plans. However, if any plan of an employer provides for catch-up contributions, all plans of the employer that provide for elective deferrals must comply with the universal availability requirement described below, to the extent applicable.

A. Eligibility for Catch-up Contributions

As under the proposed regulations, a participant is a catch-up eligible participant, and thus is permitted to make catch-up contributions, if the participant is otherwise eligible to make elective deferrals under the plan and would attain age 50 or older before the end of the participant's taxable year. In the case of a non-calendar year plan, a participant is treated as a catch-up eligible participant beginning on January 1 of the calendar year that includes the participant's 50th birthday, without regard to the plan year.

B. Determination of Catch-up Contributions

These final regulations retain the same basic structure for determining catch-up contributions as provided in the proposed regulations. Elective deferrals made by a catch-up eligible participant are treated as catch-up contributions if they exceed any otherwise applicable limit, to the extent they do not exceed the maximum dollar amount of catch-up contributions permitted under section 414(v). Catch-up contributions are determined by reference to three types of otherwise applicable limits: statutory limits, employer-provided limits, and the actual deferral percentage (ADP) limit.

A statutory limit is a limit contained in the Code on elective deferrals or annual additions permitted to be made under the plan or contract (without regard to section 414(v)). Statutory limits include the requirement under section 401(a)(30) that a plan limit all elective deferrals within a calendar year under the plan and other plans (or contracts) maintained by members of a controlled group to the amount permitted under section 402(g).

An employer-provided limit is a limit on the elective deferrals an employee can make under the plan (without regard to section 414(v)) that is contained in the terms of the plan, but is not a statutory limit or the ADP limit. A number of commentators suggested that the regulations specifically provide that a limitation on elective deferrals set by the plan administrator in accordance with plan terms is a limit contained in the terms of the plan. As noted in the preamble to the proposed regulations, the condition that an employer-provided limit be contained in the terms of the plan is intended to correspond with the requirements of § 1.401–1 that a qualified plan be a definite written program and provide for a definite predetermined formula for allocating contributions made to the plan. Accordingly, if a limit is otherwise permissible under a section 401(k) plan, the limit will also satisfy the requirement in section 414(v)(5) that the limit be contained in the terms of the plan.

The ADP limit is the highest dollar amount of elective deferrals that any highly compensated employee (HCE) is permitted under a section 401(k) plan for a plan year by reason of the ADP test under section 401(k)(3) (without regard to section 414(v)). The ADP limit is determined after taking into account all elective deferrals (other than elective deferrals that are catch-up contributions because of an employer-provided limit or statutory limit) and qualified nonelective contributions or qualified matching contributions for the plan year in accordance with section 401(k)(3) and the applicable regulations, and after any necessary correction under section 401(k)(8).

The final regulations retain the rule that the amount of elective deferrals in excess of an applicable limit is generally determined as of the end of a plan year by comparing the total elective deferrals for the plan year with the applicable limit for the plan year. For an applicable limit that is determined on the basis of

a year other than a plan year (such as the calendar year limit on elective deferrals under section 401(a)(30)), the determination of whether elective deferrals are in excess of the applicable limit is made on the basis of such other year.

As under the proposed regulations, this annual method for determining whether amounts are in excess of an applicable limit also applies to an employer-provided limit that is applied on a payroll-by-payroll basis during the plan year. A number of commentators suggested that plans that provide for payroll-by-payroll limits, or similar limits that apply to a portion of the plan year, be permitted to determine amounts in excess of an applicable limit based on the period for which the limit is applied. These commentators noted that, although a plan is permitted to determine an additional amount of elective deferrals that a catch-up eligible participant is permitted to make on a payroll-by-payroll basis, the plan could not designate these elective deferrals as catch-up contributions on the same basis. These commentators suggested that for such a plan, an annual determination process would require the plan to collect and retain additional data during the year. In many cases, plans use a definition of compensation for purposes of ADP testing that is different from the definition used during the year to determine elective deferrals. Recordkeepers for these plans must collect and retain payroll-by-payroll compensation, and then determine the employer-provided limit on an annual basis before determining the amount of elective deferrals that are catch-up contributions.

A number of advocates for a payroll-by-payroll determination of catch-up contributions acknowledged that their proposal creates a risk that ADP testing could be distorted through changes in plan limits during the year. For example, if a plan were to provide that HCEs' elective deferrals are limited, on a payroll-by-payroll basis, to 1% of compensation for the first 2 months of the plan year, and then to 15% of compensation for the remainder of the year, the result would be equivalent to treating the first dollars deferred as catch-up contributions. While few employers might be likely to adopt such a design, a payroll-by-payroll system for determining catch-up contributions would require restrictions on the extent to which changes in employer-provided limits during the year could be made.

After considering these comments, Treasury and the IRS have determined that the need for rules to prevent abuse associated with a payroll-by-payroll method of determining catch-up contributions outweighs the relative administrative advantages of that method, and these regulations retain the annual method. However, to address administrative concerns raised in these comments, these regulations also expand the alternative methods for determining an employer-provided limit in order to avoid requiring plans that use one definition of compensation for elective deferrals and another definition for ADP testing purposes to collect and retain data on both definitions.

These final regulations retain the rule in the proposed regulations that a plan that changes an employer-provided limit during the plan year is permitted to use a time-weighted average of these limits as the employer-provided limit. For example, under this alternative method, a plan that provides for an employer-provided limit of 8% for the first 6 months of the plan year and 10% for the second 6 months is permitted to use 9% as the employer-provided limit for the plan year. These final regulations also provide that the plan is permitted to use the definition of compensation used for ADP testing purposes for this weighted-average simplification, and can use this alternative method without regard to whether the employer-provided limit is changed during the plan year.

C. Treatment of Catch-up Contributions

An elective deferral that is treated as a catch-up contribution is not subject to otherwise applicable limits under the applicable employer plan and the plan will not be treated as failing otherwise applicable nondiscrimination requirements because of catch-up contributions. Under these final regulations (including changes from the proposed regulations to reflect the provisions of JCWAA), catch-up contributions are not taken into account in applying the limits of section 401(a)(30), 402(h), 403(b), 408, 415(c), or 457(b)(2) (determined without regard to section 457(b)(3)) to other contributions or benefits under the plan offering catch-up contributions or under any other plan of the employer.

Elective deferrals that are treated as catch-up contributions under a plan because they exceed a statutory limit or an employer-provided limit are disregarded for purposes of ADP testing. These catch-up contributions are subtracted from the participant's elective deferrals for the plan year prior to determining the participant's actual deferral ratio. This subtraction applies without regard to whether the catch-up eligible participant is an HCE or a nonhighly compensated employee (NHCE). If a plan needs to take corrective action under section 401(k)(8), the plan must determine the amount of elective deferrals for HCEs that are catch-up contributions because they are in excess of the ADP limit and retain such amounts. The plan would not be treated as failing section 401(k)(8) because these excess contributions are treated as catch-up contributions and retained.

Amounts in excess of an applicable limit are treated as catch-up contributions only to the extent that such excess amounts, combined with amounts previously treated as catch-up contributions for the taxable year, do not exceed the catch-up contribution limit for the year. As discussed above, whether elective deferrals in excess of an applicable limit can be treated as catch-up contributions is determined based on the year (*e.g.*, plan year, calendar year, or limitation year) with respect to which each applicable limit is applied.

The interaction of this timing rule and the catch-up contribution limit for the year is most significant for a plan with a plan year that is not the calendar year. For example, in a plan with a plan year ending on June 30, 2005, elective deferrals in excess of the employer-provided limit or the ADP limit for the plan year ending June 30, 2005, would be treated as catch-up contributions as of the last day of the plan year, up to the catch-up contribution limit for 2005. These catch-up contributions are not taken into account for purposes of compliance with section 401(a)(30) for 2005. After June 30, 2005, the catch-up eligible participant is permitted to continue to make elective deferrals up to the section 401(a)(30) limit for 2005 (disregarding any amounts treated as catch-up contributions for 2005, as of June 30, 2005) and these additional contributions are not treated as contributions in excess of the section 401(a)(30) limit. Accordingly, these additional contributions are generally taken into account under the ADP test for the plan year ending June 30, 2006. In addition, to the extent the catch-up eligible participant has not made catch-up contributions up to the catch-up contribution limit for 2005, the participant can make additional catch-up contributions in excess of the section 401(a)(30) limit for 2005. These latter contributions are catch-up contributions which will not be taken into account under the ADP test for the plan year ending June 30, 2006.

Without regard to their special treatment under certain nondiscrimination provisions and limitations under the Code, catch-up

contributions are elective deferrals and remain subject to the applicable requirements for elective deferrals. For example, catch-up contributions under an applicable employer plan that is a section 401(k) plan are subject to the distribution and vesting restrictions of section 401(k)(2)(B) and (C), although the plan provisions applicable to distributions of elective deferrals treated as catch-up contributions may differ from those applicable to other elective deferrals under the plan (as long as each provision complies with the distribution restrictions of section 401(k)(2)(B)). In addition, excess contributions treated as catch-up contributions nevertheless remain excess contributions for purposes of section 411(a)(3)(G). Therefore, the plan is permitted to provide that matching contributions related to excess contributions treated as catch-up contributions are forfeited. However, as discussed below, it is also permissible for a plan to provide that these matching contributions are not forfeited, without violating section 401(a)(4).

These final regulations retain the rules of the proposed regulations on the treatment of catch-up contributions for purposes of sections 416, 410(b) and 401(a)(4). Catch-up contributions for the current plan year are not taken into account under section 416 or 410(b). However, catch-up contributions for prior years are taken into account in determining whether a plan is top-heavy under section 416, and for purposes of average benefit percentage testing to the extent prior years' contributions are taken into account (*i.e.*, if accrued-to-date calculations are used). In addition, a plan does not fail the requirements of section 401(a)(4) merely because it permits only catch-up eligible participants to make catch-up contributions, without regard to whether the group of catch-up eligible employees would satisfy section 410(b). Similarly, if a plan applies a single matching formula to elective deferrals whether or not they are catch-up contributions, the matching formula as applied to catch-up eligible participants is not treated as a separate benefit, right, or feature under § 1.401(a)(4)–4 from the matching formula as applied to the other participants. However, the matching contributions under the plan must satisfy the actual contribution percentage test under section 401(m)(2) taking into account all matching contributions, including matching contributions on catch-up contributions.

A number of commentators indicated that some employers would not want to provide matching contributions on catch-up contributions and requested guidance on how they might accomplish that goal in light of the annual determination of whether amounts are in excess of an employer-provided limit. The IRS and Treasury believe that employers can achieve their desired goal by specifying which contributions will be matched, rather than specifying which contributions will not be matched. For example, if an employer-provided limit on elective deferrals is 10% of compensation for each payroll period, the plan can specify that matching contributions will be made based on elective deferrals that do not exceed 10% of compensation for that payroll period (and that do not exceed a statutory limit), and that matching contributions on elective deferrals in excess of the ADP limit will be forfeited, with the assurance that the plan will not be matching catch-up contributions.

D. Universal Availability

Section 414(v)(4)(A) provides that an applicable employer plan is treated as failing to comply with section 401(a)(4) unless the plan allows all catch-up eligible participants to make the same election with respect to additional elective deferrals. Section 414(v)(4)(B) provides that, for this purpose, all plans maintained by employers treated as a single employer under section 414(b), (c), (m) or (o) are treated as a single plan. The proposed regulations provided that, if an applicable employer plan otherwise subject to section 401(a)(4) provides for catch-up contributions, all other applicable employer plans in the controlled group that provide for elective deferrals (including plans not subject to section 401(a)(4)) must provide catch-up eligible participants with the same effective opportunity to make catch-up contributions. The proposed regulations also included a transition rule for collectively bargained plans and an exception related to mergers and acquisitions.

Several commentators requested that collectively bargained employees described in section 410(b)(3) be disregarded for purposes of the universal availability requirement, just as they are disregarded for purposes of section 401(a)(4) compliance. These commentators explained that it is difficult to coordinate catch-up contributions among non-collectively bargained employees and collectively bargained employees, particularly when more than one collective bargaining unit is involved. For employers participating in multiemployer plans, the difficulties are increased significantly, because of the implications for other, unrelated employers. Some commentators also requested that other groups of employees be excluded pursuant to provisions of the regulations under section 410(b) allowing employees to be excluded based on plan design, such as participants who have not met the minimum age and service requirements of section 410(a)(1) or employees in different qualified separate lines of business under section 414(r).

In response to comments, these final regulations provide that employees described in section 410(b)(3), most notably collectively bargained employees, are disregarded for purposes of determining whether an applicable employer plan complies with the universal availability requirement. Pursuant to sections 401(a)(4) and 410(b)(3), collectively bargained employees are disregarded for purposes of section 401(a)(4), without regard to plan design or an employer's choice of testing method. The final regulations do not adopt the other suggested exclusions, participants who have not met minimum age and service or participants in different qualified separate lines of business, because these exclusions are based on plan design and testing choices.

These regulations otherwise retain the basic rules of the proposed regulations relating to universal availability and provide that a plan that offers catch-up contributions satisfies the requirements of section 401(a)(4) only if all catch-up eligible participants are provided with an effective opportunity to make the same dollar amount of catch-up contributions. Catch-up eligible participants do not have an effective opportunity to make catch-up contributions unless the applicable employer plan permits each catch-up eligible participant to make sufficient elective deferrals during the year so that the participant has the opportunity to make elective deferrals up to the otherwise applicable limit plus the catch-up contribution limit. An effective opportunity could be provided in several different ways. For example, a plan that limits elective deferrals on a payroll-by-payroll basis might also provide participants with an opportunity to make catch-up contributions that is administered on a payroll-by-payroll basis (*i.e.*, by allowing catch-up eligible participants to increase their deferrals above the otherwise applicable limit by a pro-rata portion of the catch-up limit for the year). The plan would satisfy the effective opportunity requirement even though, as discussed above, whether these elective deferrals are treated as catch-up contributions would not be determined until the end of the year.

A plan will not fail the universal availability requirement solely because an employer-provided limit does not apply to all employees or different employer-provided limits apply to different groups of employees, as long as each limit satisfies the nondiscriminatory availability requirements of § 1.401(a)(4)–4 for benefits, rights, and features. Thus, for example, a plan could provide for an employer-provided limit that applies to HCEs, even though no employer-provided limit applies to NHCEs. However, as under the proposed regulations, these final regulations retain the rule that an applicable employer plan is not permitted to provide lower employer-provided limits for catch-up eligible participants. Furthermore, a plan fails to provide an effective opportunity to make catch-up contributions if it has an applicable limit (*e.g.*, an employer-provided limit) and does not permit all catch-up eligible participants to make elective deferrals in excess of that limit.

In addition to the exclusion for collectively bargained employees discussed above, these final regulations include several other exceptions to the universal availability requirement. Under these regulations, a plan does not fail the universal availability requirement because it restricts elective deferrals, including elective deferrals for catch-up eligible participants, under a cash availability limit. A cash availability limit is a limit that restricts elective deferrals to amounts available after withholding from the employee's pay (*e.g.*, after deduction of all applicable income and employment taxes). For this purpose, a limit of 75% of compensation or higher will be treated as limiting employees to amounts available after other withholdings.

These final regulations also include a broader exception to the universal availability requirement during the transition period provided under section 410(b)(6)(C) than was included in the proposed regulations, consistent with the amendments made by JCWAA. Under these final regulations, an applicable employer plan that satisfies the universal availability requirement before an acquisition or disposition described in § 1.410(b)–2(f) continues to be treated as satisfying the universal availability requirement of section 414(v)(4) through the end of the period described in section 410(b)(6)(C). These final regulations also retain a rule providing for coordination between catch-up contributions under section 414(v) and the provisions of section 457(b)(3), in accordance with section 414(v)(6)(C).

A number of comments were received on the application of the universal availability requirement to an applicable employer plan that is qualified under Puerto Rico tax law as well as under the Code. These final regulations do not affect the transitional relief granted in Notice 2002–4 that provides that an applicable employer plan will not fail to satisfy the universal availability requirement solely because another applicable employer plan of the employer that is qualified under Puerto Rico law does not provide for catch-up contributions.

E. Participants in Multiple Plans

The technical corrections in JCWAA amended section 414(v) to provide that all applicable employer plans of an employer, other than section 457 eligible governmental plans, are treated as one plan for purposes of determining the amount of catch-up contributions and all section 457 eligible governmental plans of the same employer are treated as one plan for this purpose. Statutory limits, such as the limits under section 401(a)(30) or 415, already provide for coordination among plans in the same controlled group, and elective deferrals in addition to the amounts permitted under these limits are similarly coordinated. Employer-provided limits, however, apply only to the plan that provides for the limit, and the ADP limit applies only to section 401(k) plans. Accordingly, these final regulations provide guidance on coordination of the amount in excess of these limits on a controlled-group basis.

With respect to employer-provided limits, these regulations allow a plan to permit a catch-up eligible participant to defer an amount in addition to the amount allowed under the employer-provided limit, without regard to whether the employee has already utilized his or her catch-up opportunity under another plan of the same employer. However, to the extent elective deferrals under another plan maintained by the employer have already been treated as catch-up contributions during the taxable year, the elective deferrals under the plan may be treated as catch-up contributions only up to the amount remaining under the catch-up limit for the year. Any other elective deferrals that exceed the employer-provided limit may not be treated as catch-up contributions and must satisfy the otherwise applicable nondiscrimination rules. For example, the right to make contributions in excess of the employer-provided limit is an other right or feature which must satisfy § 1.401(a)(4)–4 to the extent that the contributions are not catch-up contributions. Also, contributions in excess of the employer provided limit are taken into account under the ADP test to the extent they are not catch-up contributions.

Finally, these regulations retain the allocation rule included in the proposed regulations. When a participant is eligible under more than one applicable employer plan maintained by the same employer, the specific plan under which amounts in excess of an applicable limit are treated as catch-up contributions is permitted to be determined in any manner that is not inconsistent with the manner in which such amounts were actually deferred under the plans.

F. Excludability of Catch-up Contributions

JCWAA amended section 402(g) to increase the elective deferral limit for a catch-up eligible participant by the amount of the allowable catch-up contributions for the taxable year. The provisions of these final regulations related to these provisions are under new § 1.402(g)–2, rather than under § 1.414(v)–1, as in the proposed regulations. Under § 1.402(g)–2, the amount of elective deferrals that a catch-up eligible participant is permitted to exclude from income under section 402(g) for the taxable year is increased by the maximum amount of catch-up contributions permitted for the taxable year under section 414(v). This treatment by the catch-up eligible participant is not affected by whether the applicable employer plans treat the elective deferrals as catch-up contributions. Thus, a catch-up eligible participant who participates in plans of two or more employers is permitted to exclude from gross income elective deferrals that exceed the section 402(g) limit, even though neither plan treats those elective deferrals as catch-up contributions. In addition, the treatment by an individual of such elective deferrals as catch-up contributions will not have any effect on either employer's plan.

Effective Date

These final regulations are applicable to contributions in taxable years beginning on or after January 1, 2004. Taxpayers are permitted to rely on these final regulations and the proposed regulations for taxable years beginning prior to January 1, 2004.

Special Analyses

It has been determined that these final regulations are not a significant regulatory action as defined in

Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Because §§ 1.402(g)–2 and 1.414(v)–1 impose no new collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking that preceded these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are R. Lisa Mojiri-Azad and John T. Ricotta of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

■ Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

■ **Par. 2.** Section 1.402(g)–2 is added to read as follows:

§ 1.402(g)–2 Increased limit for catch-up contributions.

(a) *General rule.* Under section 402(g)(1)(C), in determining the amount of elective deferrals that are includible in gross income under section 402(g) for a catch-up eligible participant (within the meaning of § 1.414(v)–1(g)), the otherwise applicable dollar limit under section 402(g)(1)(B) (as increased under section 402(g)(7), to the extent applicable) shall be further increased by the applicable dollar catch-up limit as set forth under § 1.414(v)–1(c)(2).

(b) *Participants in multiple plans.* Paragraph (a) of this section applies without regard to whether the applicable employer plans (within the meaning of section 414(v)(6)) treat the elective deferrals as catch-up contributions. Thus, a catch-up eligible participant who makes elective deferrals under applicable employer plans of two or more employers that in total exceed the applicable dollar amount under section 402(g)(1) by an amount that does not exceed the applicable dollar catch-up limit under either plan may exclude the elective deferrals from gross income, even if neither applicable employer plan treats those elective deferrals as catch-up contributions.

(c) *Effective date*—(1) *Statutory effective date.* Section 402(g)(1)(C) applies to contributions in taxable years beginning on or after January 1, 2002.

(2) *Regulatory effective date.* Paragraphs (a) and (b) of this section apply to contributions in taxable years beginning on or after January 1, 2004.

■ **Par. 3.** Section 1.414(v)–1 is added to read as follows:

§ 1.414(v)–1 Catch-up contributions.

(a) *Catch-up contributions*—(1) *General rule.* An applicable employer plan shall not be treated as failing to meet any requirement of the Internal Revenue Code solely because the plan permits a catch-up eligible participant to make catch-up contributions in accordance with section 414(v) and this section. With respect to an applicable employer plan, catch-up contributions are elective deferrals made by a catch-up eligible participant that exceed any of the applicable limits set forth in paragraph (b) of this section and that are treated under the applicable employer plan as catch-up contributions, but only to the extent they do not exceed the catch-up contribution limit described in paragraph (c) of this section (determined in accordance with the special rules for employers that maintain multiple applicable employer plans in paragraph (f) of this section, if applicable). To the extent provided under paragraph (d) of this section, catch-up contributions are disregarded for purposes of various statutory limits. In addition, unless otherwise provided in paragraph (e) of this section, all catch-up eligible participants of the employer must be provided the opportunity to make catch-up contributions in order for an applicable employer plan to comply with the universal availability requirement of section 414(v)(4). The definitions in paragraph (g) of this section apply for purposes of this section and § 1.402(g)–2.

(2) *Treatment as elective deferrals.* Except as specifically provided in this section, elective deferrals treated as catch-up contributions remain subject to statutory and regulatory rules otherwise applicable to elective deferrals. For example, catch-up contributions under an applicable employer plan that is a section 401(k) plan are subject to the distribution and vesting restrictions of section 401(k)(2)(B) and (C). In addition, the plan is permitted to provide a single election for catch-up eligible participants, with the determination of whether elective deferrals are catch-up contributions being made under the terms of the plan.

(3) *Coordination with section 457(b)(3).* In the case of an applicable employer plan that is a section 457 eligible governmental plan, the catch-up contributions permitted under this section shall not apply to a catch-up eligible participant for any taxable year for which a higher limitation applies to such participant under section 457(b)(3). For additional guidance, see regulations under section 457.

(b) *Elective deferrals that exceed an applicable limit*—(1) *Applicable limits.* An applicable limit for purposes of determining catch-up contributions for a catch-up eligible participant is any of the following:

(i) *Statutory limit.* A statutory limit is a limit on elective deferrals or annual additions permitted to be made (without regard to section 414(v) and this section) with respect to an employee for a year provided in section 401(a)(30), 402(h), 403(b), 408, 415(c), or 457(b)(2) (without regard to section 457(b)(3)), as applicable.

(ii) *Employer-provided limit.* An employer-provided limit is any limit on the elective deferrals an employee is permitted to make (without regard to section 414(v) and this section) that is contained in the terms of the plan, but which is not required under the Internal Revenue Code. Thus, for example, if, in accordance with the terms of the plan, highly compensated employees are limited to a deferral percentage of 10% of compensation, this limit is an employer-provided limit that is an applicable limit with respect to the highly compensated employees.

(iii) *Actual deferral percentage (ADP) limit.* In the case of a section 401(k) plan that would fail the ADP test of section 401(k)(3) if it did not correct under section 401(k)(8), the ADP limit is the highest amount of elective deferrals that can be retained in the plan by any highly compensated employee under the rules of section 401(k)(8)(C) (without regard to paragraph (d)(2)(iii) of this section). In the case of a simplified employee pension (SEP) with a salary reduction arrangement (within the meaning of section 408(k)(6)) that would fail the requirements of section 408(k)(6)(A)(iii) if it did not correct in accordance with section 408(k)(6)(C), the ADP limit is the highest amount of elective deferrals that can be made by any highly compensated employee

under the rules of section 408(k)(6) (without regard to paragraph (d)(2)(iii) of this section).

(2) *Contributions in excess of applicable limit*—(i) *Plan year limits*—(A) *General rule.* Except as provided in paragraph (b)(2)(ii) of this section, the amount of elective deferrals in excess of an applicable limit is determined as of the end of the plan year by comparing the total elective deferrals for the plan year with the applicable limit for the plan year. In addition, except as provided in paragraph (b)(2)(i)(B) of this section, in the case of a plan that provides for separate employer-provided limits on elective deferrals for separate portions of plan compensation within the plan year, the applicable limit for the plan year is the sum of the dollar amounts of the limits for the separate portions. For example, if a plan sets a deferral percentage limit for each payroll period, the applicable limit for the plan year is the sum of the dollar amounts of the limits for the payroll periods.

(B) *Alternative method for determining employer-provided limit*—(*1*) *General rule.* If the plan limits elective deferrals for separate portions of the plan year, then, solely for purposes of determining the amount that is in excess of an employer-provided limit, the plan is permitted to provide that the applicable limit for the plan year is the product of the employee's plan year compensation and the time-weighted average of the deferral percentage limits, rather than determining the employer-provided limit as the sum of the limits for the separate portions of the year. Thus, for example, if, in accordance with the terms of the plan, highly compensated employees are limited to 8% of compensation during the first half of the plan year and 10% of compensation for the second half of the plan year, the plan is permitted to provide that the applicable limit for a highly compensated employee is 9% of the employee's plan year compensation.

(*2*) *Alternative definition of compensation permitted.* A plan using the alternative method in this paragraph (b)(2)(i)(B) is permitted to provide that the applicable limit for the plan year is determined as the product of the catch-up eligible participant's compensation used for purposes of the ADP test and the time-weighted average of the deferral percentage limits. The alternative calculation in this paragraph (b)(2)(i)(B)(*2*) is available regardless of whether the deferral percentage limits change during the plan year.

(ii) *Other year limit.* In the case of an applicable limit that is applied on the basis of a year other than the plan year (*e.g.*, the calendar-year limit on elective deferrals under section 401(a)(30)), the determination of whether elective deferrals are in excess of the applicable limit is made on the basis of such other year.

(c) *Catch-up contribution limit*—(1) *General rule.* Elective deferrals with respect to a catch-up eligible participant in excess of an applicable limit under paragraph (b) of this section are treated as catch-up contributions under this section as of a date within a taxable year only to the extent that such elective deferrals do not exceed the catch-up contribution limit described in paragraphs (c)(1) and (2) of this section, reduced by elective deferrals previously treated as catch-up contributions for the taxable year, determined in accordance with paragraph (c)(3) of this section. The catch-up contribution limit for a taxable year is generally the applicable dollar catch-up limit for such taxable year, as set forth in paragraph (c)(2) of this section. However, an elective deferral is not treated as a catch-up contribution to the extent that the elective deferral, when added to all other elective deferrals for the taxable year under any applicable employer plan of the employer, exceeds the participant's compensation (determined in accordance with section 415(c)(3)) for the taxable year. See also paragraph (f) of this section for special rules for employees who participate in more than one applicable employer plan maintained by the employer.

(2) *Applicable dollar catch-up limit*—(i) *In general.* The applicable dollar catch-up limit for an applicable employer plan, other than a plan described in section 401(k)(11) or 408(p), is determined under the following table:

For taxable years beginning in	Applicable dollar catch-up limit
2002	$1,000
2003	2,000
2004	3,000
2005	4,000
2006	5,000

(ii) *SIMPLE plans.* The applicable dollar catch-up limit for a SIMPLE 401(k) plan described in section 401(k)(11) or a SIMPLE IRA plan as described in section 408(p) is determined under the following table:

For taxable years beginning in	Applicable dollar catch-up limit
2002	$ 500
2003	1,000
2004	1,500
2005	2,000
2006	2,500

(iii) *Cost of living adjustments.* For taxable years beginning after 2006, the applicable dollar catch-up limit is the applicable dollar catch-up limit for 2006 described in paragraph (c)(2)(i) or (ii) of this section increased at the same time and in the same manner as adjustments under section 415(d), except that the base period shall be the calendar quarter beginning July 1, 2005, and any increase that is not a multiple of $500 shall be rounded to the next lower multiple of $500.

(3) *Timing rules.* For purposes of determining the maximum amount of permitted catch-up contributions for a catch-up eligible participant, the determination of whether an elective deferral is a catch-up contribution is made as of the last day of the plan year (or in the case of section 415, as of the last day of the limitation year), except that, with respect to elective deferrals in excess of an applicable limit that is tested on the basis of the taxable year or calendar year (*e.g.*, the section 401(a)(30) limit on elective deferrals), the determination of whether such elective deferrals are treated as catch-up contributions is made at the time they are deferred.

(d) *Treatment of catch-up contributions*—(1) *Contributions not taken into account for certain limits.* Catch-up contributions are not taken into account in applying the limits of section 401(a)(30), 402(h), 403(b), 408, 415(c), or 457(b)(2) (determined without regard to section 457(b)(3)) to other contributions or benefits under an applicable employer plan or any other plan of the employer.

(2) *Contributions not taken into account in application of ADP test*—(i) *Calculation of ADR.* Elective deferrals that are treated as catch-up contributions pursuant to paragraph (c) of this section with respect to a section 401(k) plan because they exceed a statutory or employer-provided limit described in paragraph (b)(1)(i) or (ii) of this section, respectively, are subtracted from the catch-up eligible participant's elective deferrals for the plan year for purposes of determining the actual deferral ratio (ADR) (as defined in regulations under section 401(k)) of a catch-up eligible participant. Similarly, elective deferrals that are treated as catch-up contributions pursuant to paragraph (c) of this section with

respect to a SEP because they exceed a statutory or employer-provided limit described in paragraph (b)(1)(i) or (ii) of this section, respectively, are subtracted from the catch-up eligible participant's elective deferrals for the plan year for purposes of determining the deferral percentage under section 408(k)(6)(D) of a catch-up eligible participant.

(ii) *Adjustment of elective deferrals for correction purposes.* For purposes of the correction of excess contributions in accordance with section 401(k)(8)(C), elective deferrals under the plan treated as catch-up contributions for the plan year and not taken into account in the ADP test under paragraph (d)(2)(i) of this section are subtracted from the catch-up eligible participant's elective deferrals under the plan for the plan year.

(iii) *Excess contributions treated as catch-up contributions.* A section 401(k) plan that satisfies the ADP test of section 401(k)(3) through correction under section 401(k)(8) must retain any elective deferrals that are treated as catch-up contributions pursuant to paragraph (c) of this section because they exceed the ADP limit in paragraph (b)(1)(iii) of this section. In addition, a section 401(k) plan is not treated as failing to satisfy section 401(k)(8) merely because elective deferrals described in the preceding sentence are not distributed or recharacterized as employee contributions. Similarly, a SEP is not treated as failing to satisfy section 408(k)(6)(A)(iii) merely because catch-up contributions are not treated as excess contributions with respect to a catch-up eligible participant under the rules of section 408(k)(6)(C). Notwithstanding the fact that elective deferrals described in this paragraph (d)(2)(iii) are not distributed, such elective deferrals are still considered to be excess contributions under section 401(k)(8), and accordingly, matching contributions with respect to such elective deferrals are permitted to be forfeited under the rules of section 411(a)(3)(G).

(3) *Contributions not taken into account for other nondiscrimination purposes*—(i) *Application for top-heavy.* Catch-up contributions with respect to the current plan year are not taken into account for purposes of section 416. However, catch-up contributions for prior years are taken into account for purposes of section 416. Thus, catch-up contributions for prior years are included in the account balances that are used in determining whether the plan is top-heavy under section 416(g).

(ii) *Application for section 410(b).* Catch-up contributions with respect to the current plan year are not taken into account for purposes of section 410(b). Thus, catch-up contributions are not taken into account in determining the average benefit percentage under § 1.410(b)–5 for the year if benefit percentages are determined based on current year contributions. However, catch-up contributions for prior years are taken into account for purposes of section 410(b). Thus, catch-up contributions for prior years would be included in the account balances that are used in determining the average benefit percentage if allocations for prior years are taken into account.

(4) *Availability of catch-up contributions.* An applicable employer plan does not violate § 1.401(a)(4)–4 merely because the group of employees for whom catch-up contributions are currently available (*i.e.*, the catch-up eligible participants) is not a group of employees that would satisfy section 410(b) (without regard to § 1.410(b)–5). In addition, a catch-up eligible participant is not treated as having a right to a different rate of allocation of matching contributions merely because an otherwise nondiscriminatory schedule of matching rates is applied to elective deferrals that include catch-up contributions. The rules in this paragraph (d)(4) also apply for purposes of satisfying the requirements of section 403(b)(12).

(e) *Universal availability requirement*—(1) *General rule*—(i) *Effective opportunity.* An applicable employer plan that offers catch-up contributions and that is otherwise subject to section 401(a)(4) (including a plan that is subject to section 401(a)(4) pursuant to section 403(b)(12)) will not satisfy the requirements of section 401(a)(4) unless all catch-up eligible participants who participate under any applicable employer plan maintained by the employer are provided with an effective opportunity to make the same dollar amount of catch-up contributions. A plan fails to provide an effective opportunity to make catch-up contributions if it has an applicable limit (*e.g.*, an employer-provided limit) that applies to a catch-up eligible participant and does not permit the participant to make elective deferrals in excess of that limit. An applicable employer plan does not fail to satisfy the universal availability requirement of this paragraph (e) solely because an employer-provided limit does not apply to all employees or different limits apply to different groups of employees under paragraph (b)(2)(i) of this section. However, a plan may not provide lower employer-provided limits for catch-up eligible participants.

(ii) *Certain practices permitted*—(A) *Proration of limit.* An applicable employer plan does not fail to satisfy the universal availability requirement of this paragraph (e) merely because the plan allows participants to defer an amount equal to a specified percentage of compensation for each payroll period and for each payroll period permits each catch-up eligible participant to defer a pro-rata share of the applicable dollar catch-up limit in addition to that amount.

(B) *Cash availability.* An applicable employer plan does not fail to satisfy the universal availability requirement of this paragraph (e) merely because it restricts the elective deferrals of any employee (including a catch-up eligible participant) to amounts available after other withholding from the employee's pay (*e.g.*, after deduction of all applicable income and employment taxes). For this purpose, an employer limit of 75% of compensation or higher will be treated as limiting employees to amounts available after other withholdings.

(2) *Certain employees disregarded.* An applicable employer plan does not fail to satisfy the universal availability requirement of this paragraph (e) merely because employees described in section 410(b)(3) (*e.g.*, collectively bargained employees) are not provided the opportunity to make catch-up contributions.

(3) *Exception for certain plans.* An applicable employer plan does not fail to satisfy the universal availability requirement of this paragraph (e) merely because another applicable employer plan that is a section 457 eligible governmental plan does not provide for catch-up contributions to the extent set forth in section 414(v)(6)(C) and paragraph (a)(3) of this section.

(4) *Exception for section 410(b)(6)(C)(ii) period.* If an applicable employer plan satisfies the universal availability requirement of this paragraph (e) before an acquisition or disposition described in § 1.410(b)–2(f) and would fail to satisfy the universal availability requirement of this paragraph (e) merely because of such event, then the applicable employer plan shall continue to be treated as satisfying this paragraph (e) through the end of the period determined under section 410(b)(6)(C)(ii).

(f) *Special rules for an employer that sponsors multiple plans*—(1) *General rule.* For purposes of paragraph (c) of this section, all applicable employer plans, other than section 457 eligible governmental plans, maintained by the same employer are treated as one plan and all section 457 eligible

governmental plans maintained by the same employer are treated as one plan. Thus, the total amount of catch-up contributions under all applicable employer plans of an employer (other than section 457 eligible governmental plans) is limited to the applicable dollar catch-up limit for the taxable year, and the total amount of catch-up contributions for all section 457 eligible governmental plans of an employer is limited to the applicable dollar catch-up limit for the taxable year.

(2) *Coordination of employer-provided limits.* An applicable employer plan is permitted to allow a catch-up eligible participant to defer amounts in excess of an employer-provided limit under that plan without regard to whether elective deferrals made by the participant have been treated as catch-up contributions for the taxable year under another applicable employer plan aggregated with such plan under this paragraph (f). However, to the extent elective deferrals under another plan maintained by the employer have already been treated as catch-up contributions during the taxable year, the elective deferrals under the plan may be treated as catch-up contributions only up to the amount remaining under the catch-up limit for the year. Any other elective deferrals that exceed the employer-provided limit may not be treated as catch-up contributions and must satisfy the otherwise applicable nondiscrimination rules. For example, the right to make contributions in excess of the employer-provided limit is another right or feature which must satisfy § 1.401(a)(4)–4 to the extent that the contributions are not catch-up contributions. Also, contributions in excess of the employer provided limit are taken into account under the ADP test to the extent they are not catch-up contributions.

(3) *Allocation rules.* If a catch-up eligible participant makes additional elective deferrals in excess of an applicable limit under paragraph (b)(1) of this section under more than one applicable employer plan that is aggregated under the rules of this paragraph (f), the applicable employer plan under which elective deferrals in excess of an applicable limit are treated as catch-up contributions is permitted to be determined in any manner that is not inconsistent with the manner in which such amounts were actually deferred under the plan.

(g) *Definitions*—(1) *Applicable employer plan.* The term applicable employer plan means a section 401(k) plan, a SIMPLE IRA plan as defined in section 408(p), a simplified employee pension plan as defined in section 408(k) (SEP), a plan or contract that satisfies the requirements of section 403(b), or a section 457 eligible governmental plan.

(2) *Elective deferral.* The term elective deferral means an elective deferral within the meaning of section 402(g)(3) or any contribution to a section 457 eligible governmental plan.

(3) *Catch-up eligible participant.* An employee is a catch-up eligible participant for a taxable year if—

(i) The employee is eligible to make elective deferrals under an applicable employer plan (without regard to section 414(v) or this section); and

(ii) The employee's 50th or higher birthday would occur before the end of the employee's taxable year.

(4) *Other definitions.* (i) The terms employer, employee, section 401(k) plan, and highly compensated employee have the meanings provided in § 1.410(b)–9.

(ii) The term section 457 eligible governmental plan means an eligible deferred compensation plan described in section 457(b) that is established and maintained by an eligible employer described in section 457(e)(1)(A).

(h) *Examples.* The following examples illustrate the application of this section. For purposes of these examples, the limit under section 401(a)(30) is $15,000 and the applicable dollar catch-up limit is $5,000 and, except as specifically provided, the plan year is the calendar year. In addition, it is assumed that the participant's elective deferrals under all plans of the employer do not exceed the participant's section 415(c)(3) compensation, that the taxable year of the participant is the calendar year and that any correction pursuant to section 401(k)(8) is made through distribution of excess contributions. The examples are as follows:

Example 1. (i) Participant A is eligible to make elective deferrals under a section 401(k) plan, Plan P. Plan P does not limit elective deferrals except as necessary to comply with sections 401(a)(30) and 415. In 2006, Participant A is 55 years old. Plan P also provides that a catch-up eligible participant is permitted to defer amounts in excess of the section 401(a)(30) limit up to the applicable dollar catch-up limit for the year. Participant A defers $18,000 during 2006.

(ii) Participant A's elective deferrals in excess of the section 401(a)(30) limit ($3,000) do not exceed the applicable dollar catch-up limit for 2006 ($5,000). Under paragraph (a)(1) of this section, the $3,000 is a catch-up contribution and, pursuant to paragraph (d)(2)(i) of this section, it is not taken into account in determining Participant A's ADR for purposes of section 401(k)(3).

Example 2. (i) Participants B and C, who are highly compensated employees each earning $120,000, are eligible to make elective deferrals under a section 401(k) plan, Plan Q. Plan Q limits elective deferrals as necessary to comply with section 401(a)(30) and 415, and also provides that no highly compensated employee may make an elective deferral at a rate that exceeds 10% of compensation. However, Plan Q also provides that a catch-up eligible participant is permitted to defer amounts in excess of 10% during the plan year up to the applicable dollar catch-up limit for the year. In 2006, Participants B and C are both 55 years old and, pursuant to the catch-up provision in Plan Q, both elect to defer 10% of compensation plus a pro-rata portion of the $5,000 applicable dollar catch-up limit for 2006. Participant B continues this election in effect for the entire year, for a total elective contribution for the year of $17,000. However, in July 2006, after deferring $8,500, Participant C discontinues making elective deferrals.

(ii) Once Participant B's elective deferrals for the year exceed the section 401(a)(30) limit ($15,000), subsequent elective deferrals are treated as catch-up contributions as they are deferred, provided that such elective deferrals do not exceed the catch-up contribution limit for the taxable year. Since the $2,000 in elective deferrals made after Participant B reaches the section 402(g) limit for the calendar year does not exceed the applicable dollar catch-up limit for 2006, the entire $2,000 is treated as a catch-up contribution.

(iii) As of the last day of the plan year, Participant B has exceeded the employer-provided limit of 10% (10% of $120,000 or $12,000 for Participant B) by an additional $3,000. Since the additional $3,000 in elective deferrals does not exceed the $5,000 applicable dollar catch-up limit for 2006, reduced by the $2,000 in elective deferrals previously treated as catch-up contributions, the entire $3,000 of elective deferrals is treated as a catch-up contribution.

(iv) In determining Participant B's ADR, the $5,000 of catch-up contributions are subtracted from Participant B's elective deferrals for the plan year under paragraph (d)(2)(i) of this section. Accordingly, Participant B's ADR is 10% ($12,000/$120,000). In addition, for purposes of applying the rules of section 401(k)(8), Participant B is treated as having elective deferrals of $12,000.

(v) Participant C's elective deferrals for the year do not exceed an applicable limit for the plan year. Accordingly, Participant C's $8,500 of elective deferrals must be taken into account in determining Participant C's ADR for purposes of section 401(k)(3).

Example 3. (i) The facts are the same as in *Example 2*, except that Plan Q is amended to change the maximum permitted deferral percentage for highly compensated employees to 7%, effective for deferrals after April 1, 2006. Participant B, who has earned $40,000 in the first 3 months of the year and has been deferring at a rate of 10% of compensation plus a pro-rata portion of the $5,000 applicable dollar catch-up limit for 2006, reduces the 10% of pay deferral rate to 7% for the remaining 9 months of the year (while continuing to defer a pro-rata portion of the $5,000 applicable dollar catch-up limit

for 2006). During those 9 months, Participant B earns $80,000. Thus, Participant B's total elective deferrals for the year are $14,600 ($4,000 for the first 3 months of the year plus $5,600 for the last 9 months of the year plus an additional $5,000 throughout the year).

(ii) The employer-provided limit for Participant B for the plan year is $9,600 ($4,000 for the first 3 months of the year, plus $5,600 for the last 9 months of the year). Accordingly, Participant B's elective deferrals for the year that are in excess of the employer-provided limit are $5,000 (the excess of $14,600 over $9,600), which does not exceed the applicable dollar catch-up limit of $5,000.

(iii) Alternatively, Plan Q may provide that the employer-provided limit is determined as the time-weighted average of the different deferral percentage limits over the course of the year. In this case, the time-weighted average limit is 7.75% for all participants, and the applicable limit for Participant B is 7.75% of $120,000, or $9,300. Accordingly, Participant B's elective deferrals for the year that are in excess of the employer-provided limit are $5,300 (the excess of $14,600 over $9,300). Since the amount of Participant B's elective deferrals in excess of the employer-provided limit ($5,300) exceeds the applicable dollar catch-up limit for the taxable year, only $5,000 of Participant B's elective deferrals may be treated as catch-up contributions. In determining Participant B's actual deferral ratio, the $5,000 of catch-up contributions are subtracted from Participant B's elective deferrals for the plan year under paragraph (d)(2)(i) of this section. Accordingly, Participant B's actual deferral ratio is 8% ($9,600/$120,000). In addition, for purposes of applying the rules of section 401(k)(8), Participant B is treated as having elective deferrals of $9,600.

Example 4. (i) The facts are the same as in *Example 1*. In addition to Participant A, Participant D is a highly compensated employee who is eligible to make elective deferrals under Plan P. During 2006, Participant D, who is 60 years old, elects to defer $14,000.

(ii) The ADP test is run for Plan P (after excluding the $3,000 in catch-up contributions from Participant A's elective deferrals), but Plan P needs to take corrective action in order to pass the ADP test. After applying the rules of section 401(k)(8)(C) to allocate the total excess contributions determined under section 401(k)(8)(B), the maximum deferrals which may be retained by any highly compensated employee in Plan P is $12,500.

(iii) Pursuant to paragraph (b)(1)(iii) of this section, the ADP limit under Plan P of $12,500 is an applicable limit. Accordingly, $1,500 of Participant D's elective deferrals exceed the applicable limit. Similarly, $2,500 of Participant A's elective deferrals (other than the $3,000 of elective deferrals treated as catch-up contributions because they exceed the section 401(a)(30) limit) exceed the applicable limit.

(iv) The $1,500 of Participant D's elective deferrals that exceed the applicable limit are less than the applicable dollar catch-up limit and are treated as catch-up contributions. Pursuant to paragraph (d)(2)(iii) of this section, Plan P must retain Participant D's $1,500 in elective deferrals and Plan P is not treated as failing to satisfy section 401(k)(8) merely because the elective deferrals are not distributed to Participant D.

(v) The $2,500 of Participant A's elective deferrals that exceed the applicable limit are greater than the portion of the applicable dollar catch-up limit ($2,000) that remains after treating the $3,000 of elective deferrals in excess of the section 401(a)(30) limit as catch-up contributions. Accordingly, $2,000 of Participant A's elective deferrals are treated as catch-up contributions. Pursuant to paragraph (d)(2)(iii) of this section, Plan P must retain Participant A's $2,000 in elective deferrals and Plan P is not treated as failing to satisfy section 401(k)(8) merely because the elective deferrals are not distributed to Participant A. However, $500 of Participant A's elective deferrals cannot be treated as catch-up contributions and must be distributed to Participant A in order to satisfy section 401(k)(8).

Example 5. (i) Participant E is a highly compensated employee who is a catch-up eligible participant under a section 401(k) plan, Plan R, with a plan year ending October 31, 2006. Plan R does not limit elective deferrals except as necessary to comply with section 401(a)(30) and section 415. Plan R permits all catch-up eligible participants to defer an additional amount equal to the applicable dollar catch-up limit for the year ($5,000) in excess of the section 401(a)(30) limit. Participant E did not exceed the section 401(a)(30) limit in 2005 and did not exceed the ADP limit for the plan year ending October 31, 2005. Participant E made $3,200 of deferrals in the period November 1, 2005 through December 31, 2005 and an additional $16,000 of deferrals in the first 10 months of 2006, for a total of $19,200 in elective deferrals for the plan year.

(ii) Once Participant E's elective deferrals for the calendar year 2006 exceed $15,000, subsequent elective deferrals are treated as catch-up contributions at the time they are deferred, provided that such elective deferrals do not exceed the applicable dollar catch-up limit for the taxable year. Since the $1,000 in elective deferrals made after Participant E reaches the section 402(g) limit for the calendar year does not exceed the applicable dollar catch-up limit for 2006, the entire $1,000 is a catch-up contribution. Pursuant to paragraph (d)(2)(i) of this section, $1,000 is subtracted from Participant E's $19,200 in elective deferrals for the plan year ending October 31, 2006 in determining Participant E's ADR for that plan year.

(iii) The ADP test is run for Plan R (after excluding the $1,000 in elective deferrals in excess of the section 401(a)(30) limit), but Plan R needs to take corrective action in order to pass the ADP test. After applying the rules of section 401(k)(8)(C) to allocate the total excess contributions determined under section 401(k)(8)(C), the maximum deferrals that may be retained by any highly compensated employee under Plan R for the plan year ending October 31, 2006 (the ADP limit) is $14,800.

(iv) Under paragraph (d)(2)(ii) of this section, elective deferrals that exceed the section 401(a)(30) limit under Plan R are also subtracted from Participant E's elective deferrals under Plan R for purposes of applying the rules of section 401(k)(8). Accordingly, for purposes of correcting the failed ADP test, Participant E is treated as having contributed $18,200 of elective deferrals in Plan R. The amount of elective deferrals that would have to be distributed to Participant E in order to satisfy section 401(k)(8)(C) is $3,400 ($18,200 minus $14,800), which is less than the excess of the applicable dollar catch-up limit ($5,000) over the elective deferrals previously treated as catch-up contributions under Plan R for the taxable year ($1,000). Under paragraph (d)(2)(iii) of this section, Plan R must retain Participant E's $3,400 in elective deferrals and is not treated as failing to satisfy section 401(k)(8) merely because the elective deferrals are not distributed to Participant E.

(v) Even though Participant E's elective deferrals for the calendar year 2006 have exceeded the section 401(a)(30) limit, Participant E can continue to make elective deferrals during the last 2 months of the calendar year, since Participant E's catch-up contributions for the taxable year are not taken into account in applying the section 401(a)(30) limit for 2006. Thus, Participant E can make an additional contribution of $3,400 ($15,000 minus ($16,000 minus $4,400)) without exceeding the section 401(a)(30) for the calendar year and without regard to any additional catch-up contributions. In addition, Participant E may make additional catch-up contributions of $600 (the $5,000 applicable dollar catch-up limit for 2006, reduced by the $4,400 ($1,000 plus $3,400) of elective deferrals previously treated as catch-up contributions during the taxable year). The $600 of catch-up contributions will not be taken into account in the ADP test for the plan year ending October 31, 2007.

Example 6. (i) The facts are the same as in *Example 5*, except that Participant E exceeded the section 401(a)(30) limit for 2005 by $1,300 prior to October 31, 2005, and made $600 of elective deferrals in the period November 1, 2005, through December 31, 2005 (which were catch-up contributions for 2005). Thus, Participant E made $16,600 of elective deferrals for the plan year ending October 31, 2006.

(ii) Once Participant E's elective deferrals for the calendar year 2006 exceed $15,000, subsequent elective deferrals are treated as catch-up contributions as they are deferred, provided that such elective deferrals do not exceed the applicable dollar catch-up limit for the taxable year. Since the $1,000 in elective deferrals made after Participant E reaches the section 402(g) limit for calendar year 2006 does not exceed the applicable dollar catch-up limit for 2006, the entire $1,000 is a catch-up contribution. Pursuant to paragraph (d)(2)(i) of this section, $1,000 is subtracted from Participant E's elective deferrals in determining Participant E's ADR for the plan year ending October 31, 2006. In addition, the $600 of catch-up contributions from the period November 1, 2005 to December 31, 2005 are subtracted from Participant E's elective deferrals in determining Participant E's ADR. Thus, the total elective deferrals taken into account in

determining Participant E's ADR for the plan year ending October 31, 2006, is $15,000 ($16,600 in elective deferrals for the current plan year, less $1,600 in catch-up contributions).

(iii) The ADP test is run for Plan R (after excluding the $1,600 in elective deferrals in excess of the section 401(a)(30) limit), but Plan R needs to take corrective action in order to pass the ADP test. After applying the rules of section 401(k)(8)(C) to allocate the total excess contributions determined under section 401(k)(8)(C), the maximum deferrals that may be retained by any highly compensated employee under Plan R (the ADP limit) is $14,800.

(iv) Under paragraph (d)(2)(ii) of this section, elective deferrals that exceed the section 401(a)(30) limit under Plan R are also subtracted from Participant E's elective deferrals under Plan R for purposes of applying the rules of section 401(k)(8). Accordingly, for purposes of correcting the failed ADP test, Participant E is treated as having contributed $15,000 of elective deferrals in Plan R. The amount of elective deferrals that would have to be distributed to Participant E in order to satisfy section 401(k)(8)(C) is $200 ($15,000 minus $14,800), which is less than the excess of the applicable dollar catch-up limit ($5,000) over the elective deferrals previously treated as catch-up contributions under Plan R for the taxable year ($1,000). Under paragraph (d)(2)(iii) of this section, Plan R must retain Participant E's $200 in elective deferrals and is not treated as failing to satisfy section 401(k)(8) merely because the elective deferrals are not distributed to Participant E.

(v) Even though Participant E's elective deferrals for calendar year 2006 have exceeded the section 401(a)(30) limit, Participant E can continue to make elective deferrals during the last 2 months of the calendar year, since Participant E's catch-up contributions for the taxable year are not taken into account in applying the section 401(a)(30) limit for 2006. Thus Participant E can make an additional contribution of $200 ($15,000 minus ($16,000 minus $1,200)) without exceeding the section 401(a)(30) for the calendar year and without regard to any additional catch-up contributions. In addition, Participant E may make additional catch-up contributions of $3,800 (the $5,000 applicable dollar catch-up limit for 2006, reduced by the $1,200 ($1,000 plus $200) of elective deferrals previously treated as catch-up contributions during the taxable year). The $3,800 of catch-up contributions will not be taken into account in the ADP test for the plan year ending October 31, 2007.

Example 7. (i) Participant F, who is 58 years old, is a highly compensated employee who earns $100,000 per year. Participant F participates in a section 401(k) plan, Plan S, for the first 6 months of the year and then transfers to another section 401(k) plan, Plan T, sponsored by the same employer, for the second 6 months of the year. Plan S limits highly compensated employees' elective deferrals to 6% of compensation for the period of participation, but permits catch-up eligible participants to defer amounts in excess of 6% during the plan year, up to the applicable dollar catch-up limit for the year. Plan T limits highly compensated employees' elective deferrals to 8% of compensation for the period of participation, but permits catch-up eligible participants to defer amounts in excess of 8% during the plan year, up to the applicable dollar catch-up limit for the year. Participant F earned $50,000 in the first 6 months of the year and deferred $6,000 under Plan S. Participant F also deferred $6,500 under Plan T.

(ii) As of the last day of the plan year, Participant F has $3,000 in elective deferrals under Plan S that exceed the employer-provided limit of $3,000. Under Plan T, Participant F has $2,500 in elective deferrals that exceed the employer-provided limit of $4,000. The total amount of elective deferrals in excess of employer-provided limits, $5,500, exceeds the applicable dollar catch-up limit by $500. Accordingly, $500 of the elective deferrals in excess of the employer-provided limits are not catch-up contributions and are treated as regular elective deferrals (and are taken into account in the ADP test). The determination of which elective deferrals in excess of an applicable limit are treated as catch-up contributions is permitted to be made in any manner that is not inconsistent with the manner in which such amounts were actually deferred under Plan S and Plan T.

Example 8. (i) Employer X sponsors Plan P, which provides for matching contributions equal to 50% of elective deferrals that do not exceed 10% of compensation. Elective deferrals for highly compensated employees are limited, on a payroll-by-payroll basis, to 10% of compensation. Employer X pays employees on a monthly basis. Plan P also provides that elective contributions are limited in accordance with section 401(a)(30) and other applicable statutory limits. Plan P also provides for catch-up contributions. Under Plan P, for purposes of calculating the amount to be treated as catch-up contributions (and to be excluded from the ADP test), amounts in excess of the 10% limit for highly compensated employees are determined at the end of the plan year based on compensation used for purposes of ADP testing (testing compensation), a definition of compensation that is different from the definition used under the plan for purposes of calculating elective deferrals and matching contributions during the plan year (deferral compensation).

(ii) Participant A, a highly compensated employee, is a catch-up eligible participant under Plan P with deferral compensation of $10,000 per monthly payroll period. Participant A defers 10% per payroll period for the first 10 months of the year, and is allocated a matching contribution each payroll period of $500. In addition, Participant A defers an additional $4,000 during the first 10 months of the year. Participant A then reduces deferrals during the last 2 months of the year to 5% of compensation. Participant A is allocated a matching contribution of $250 for each of the last 2 months of the plan year. For the plan year, Participant A has $15,000 in elective deferrals and $5,500 in matching contributions.

(iii) A's testing compensation is $118,000. At the end of the plan year, based on 10% of testing compensation, or $11,800, Plan P determines that A has $3,200 in deferrals that exceed the 10% employer provided limit. Plan P excludes $3,200 from ADP testing and calculates A's ADR as $11,800 divided by $118,000, or 10%. Although A has not been allocated a matching contribution equal to 50% of $11,800, because Plan P provides that matching contributions are calculated based on elective deferrals during a payroll period as a percentage of deferral compensation, Plan P is not required to allocate an additional $400 of matching contributions to A.

(i) *Effective date*—(1) *Statutory effective date.* Section 414(v) applies to contributions in taxable years beginning on or after January 1, 2002.

(2) *Regulatory effective date.* Paragraphs (a) through (h) of this section apply to contributions in taxable years beginning on or after January 1, 2004.

Robert E. Wenzel,

Deputy Commissioner for Services and Enforcement.

Approved: June 27, 2003.

Pamela F. Olson,

Assistant Secretary (Tax Policy).

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ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 52

[VA127–5064; FRL–7523–2]

Approval and Promulgation of Air Quality Implementation Plans; Virginia Nitrogen Oxides Budget Trading Program

AGENCY: Environmental Protection Agency (EPA).

ACTION: Final rule.

SUMMARY: EPA is approving a State Implementation Plan (SIP) revision submitted by the Commonwealth of Virginia which consists of its nitrogen oxides (NO_X) allowance trading program for large electric generating and industrial units, with the exception of the programs's NO_X allowance banking provisions, which EPA is conditionally approving. The effect of this action is to approve the Virginia NO_X Budget Trading Program, with conditions on the approval of its allowance banking provisions, because the program substantively addresses the requirements of Phase I of the NO_X SIP Call which will significantly reduce ozone transport in the eastern United States.

EFFECTIVE DATE: This final rule is effective on August 7, 2003.