

holidays. The Docket Office (telephone 1-800-647-5527) is on the plaza level of the Department of Transportation NASSIF Building at the above address.

**FOR FURTHER INFORMATION CONTACT:**

Kathy Randolph, Air Traffic Division, Airspace Branch, ACE-520C, DOT Regional Headquarters Building, Federal Aviation Administration, 901 Locust, Kansas City, MO 64106; telephone: (816) 329-2525.

**SUPPLEMENTARY INFORMATION:**

**Comments Invited**

Interested parties are invited to participate in this proposed rulemaking by submitting such written data, views, or arguments, as they may desire. Comments that provide the factual basis supporting the views and suggestions presented are particularly helpful in developing reasoned regulatory decisions on the proposal. Comments are specifically invited on the overall regulatory, aeronautical, economic, environmental, and energy-related aspects of the proposal. Communications should identify both docket numbers and be submitted in triplicate to the address listed above. Commenters wishing the FAA to acknowledge receipt of their comments on this notice must submit with those comments a self-addressed, stamped postcard on which the following statement is made: "Comments to Docket No. FAA-2004-19504/Airspace Docket No. 04-ACE-64". The postcard will be date/time stamped and returned to the commenter.

**Availability of NPRM's**

An electronic copy of this document may be downloaded through the Internet at <http://dms.dot.gov>. Recently published rulemaking documents can also be accessed through the FAA's Web page at <http://www.faa.gov> or the Superintendent of Document's Web page at <http://www.access.gpo.gov/nara>.

Additionally, any person may obtain a copy of this notice by submitting a request to the Federal Aviation Administration, Office of Air Traffic Airspace Management, ATA-400, 800 Independence Avenue, SW., Washington, DC 20591, or by calling (202) 267-8783. Communications must identify both docket numbers for this notice. Persons interested in being placed on a mailing list for future NPRM's should contact the FAA's Office of Rulemaking (202) 267-9677, to request a copy of Advisory Circular No. 11-2A, Notice of Proposed Rulemaking Distribution System, which describes the application procedure.

**The Proposal**

This notice proposes to amend Part 71 of the Federal Aviation Regulation (14 CFR Part 71) to establish Class E airspace designated as a surface area for Colonel James Jabara Airport at Wichita, KS. Controlled airspace extending upward from the surface of the earth is needed to contain aircraft executing instrument approach procedures. Weather observations would be provided by an Automated Surface Observing System (ASOS) and communications would be direct with Wichita Approach Control. The area would be depicted on appropriate aeronautical charts.

Class E airspace areas designated as surface areas are published in Paragraph 6002 of FAA Order 7400.9M, dated August 30, 2004, and effective September 16, 2004, which is incorporated by reference in 14 CFR 71.1. The Class E airspace designation listed in this document would be published subsequently in the Order.

The FAA has determined that this proposed regulation only involves an established body of technical regulations for which frequent and routine amendments are necessary to keep them operationally current. It, therefore, (1) is not a "significant regulatory action" under Executive Order 12866; (2) is not a "significant rule" under DOT Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); and (3) does not warrant preparation of a Regulatory Evaluation as the anticipated impact is so minimal. Since this is a routine matter that will only affect air traffic procedures and air navigation, it is certified that this rule, when promulgated, will not have a significant economic impact on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

**List of Subjects in 14 CFR Part 71**

Airspace, Incorporation by reference, Navigation (Air).

**The Proposed Amendment**

In consideration of the foregoing, the Federal Aviation Administration proposes to amend 14 CFR part 71 as follows:

**PART 71—DESIGNATION OF CLASS A, CLASS B, CLASS C, CLASS D, AND CLASS E AIRSPACE AREAS; AIRWAYS; ROUTES; AND REPORTING POINTS**

1. The authority citation for part 71 continues to read as follows:

**Authority:** 49 U.S.C. 106(g), 40103, 40113, 40120; E.O. 10854, 24 FR 9565, 3 CFR, 1959-1963 Comp., p. 389.

**§ 71.1 [Amended]**

2. The incorporation by reference in 14 CFR 71.1 of Federal Aviation Administration Order 7400.9M, Airspace Designations and Reporting Points, dated August 30, 2004, and effective September 16, 2004, is amended as follows:

*Paragraph 6002 Class E Airspace Designated as Surface Areas.*

\* \* \* \* \*

**ACE KS E2 Wichita Colonel James Jabara Airport, KS**

Wichita, Colonel James Jabara Airport, KS (Lat. 37°44'51" N., long. 97°13'16" W.)

Within a 4-mile radius of Colonel James Jabara Airport; excluding that airspace within the Wichita Mid-Continent Airport, KS Class C airspace area and the Wichita, McConnell AFB, KS Class D airspace area.

\* \* \* \* \*

Issued in Kansas City, MO, on October 29, 2004.

**Anthony D. Roetzel,**

*Acting Area Director, Western Flight Services Operations.*

[FR Doc. 04-24977 Filed 11-9-04; 8:45 am]

**BILLING CODE 4910-13-M**

**DEPARTMENT OF TREASURY**

**Internal Revenue Service**

**26 CFR Part 1**

**[REG-114726-04]**

**RIN 1545-BD23**

**Distributions From a Pension Plan Under a Phased Retirement Program**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** This notice of proposed rulemaking contains proposed amendments to the Income Tax Regulations under section 401(a) of the Internal Revenue Code. These proposed regulations provide rules permitting distributions to be made from a pension plan under a phased retirement program and set forth requirements for a bona fide phased retirement program. The proposed regulations will provide the public with guidance regarding distributions from qualified pension plans and will affect administrators of, and participants in, such plans.

**DATES:** Written or electronic comments and requests for a public hearing must be received by February 8, 2005.

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG-114726-04), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-114726-04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically, via the IRS Internet site at [www.irs.gov/reg](http://www.irs.gov/reg) or via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (indicate IRS and REG-114726-04).

**FOR FURTHER INFORMATION CONTACT:** Concerning the regulations, Cathy A. Vohs, (202) 622-6090; concerning submissions and requests for a public hearing, contact Sonya Cruse, (202) 622-7180 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:**

**Background**

As people are living longer, healthier lives, there is a greater risk that individuals may outlive their retirement savings. In addition, employers have expressed interest in encouraging older, more experienced workers to stay in the workforce. One approach that some employers have implemented is to offer employees the opportunity for "phased retirement."

While there is no single approach to phased retirement, these arrangements generally provide employees who are at or near eligibility for retirement with the opportunity for a reduced schedule or workload, thereby providing a smoother transition from full-time employment to retirement. These arrangements permit the employer to retain the services of an experienced employee and provide the employee with the opportunity to continue active employment at a level that also allows greater flexibility and time away from work.

During such a transition arrangement, employees may wish to supplement their part-time income with a portion of their retirement savings. However, phased retirement can also increase the risk of outliving retirement savings for employees who begin drawing upon their retirement savings before normal retirement age. Even though the annuity distribution options offered by defined benefit plans preclude outliving benefits, early distribution of a portion of the employee's benefit will reduce the benefits available after full retirement. On the other hand, phased retirement also can provide employees additional time to save for retirement because employees continue working while they are able to do so, and can

accrue additional benefits and reduce or forgo early spending of their retirement savings.

In light of this background, Treasury and the IRS issued Notice 2002-43 in the Cumulative Bulletin (2002-27 C.B. 38 (July 8, 2002)), in which comments were requested regarding phased retirement. Notice 2002-43 specifically requested comments on a wide variety of issues, including the following:

- Under what circumstances, if any, would permitting distributions from a defined benefit plan before an employee attains normal retirement age be consistent with the requirement that a defined benefit plan be established and maintained primarily for purposes of providing benefits after retirement, such as the extent to which an employee has actually reduced his or her workload?
- If there are such circumstances, how should any early retirement subsidy be treated?

**Comments Received**

Sixteen written comments were formally submitted in response to Notice 2002-43. These comments are in addition to the substantial number of articles and other published materials addressing phased retirement.<sup>1</sup>

While some of the comments expressed concerns over the potential for both dissipation of retirement funds and violation of age discrimination laws, commentators generally responded favorably to the proposal to provide guidance on facilitating phased retirement arrangements. These commentators noted that permitting pension distributions during phased retirement would be attractive to both employers and employees. Commentators also indicated that any guidance issued should provide that establishment of phased retirement arrangements be optional on the part of the employer and that participation in any such arrangement be voluntary on the part of the employee.

Most of the comments recommended that eligibility to participate in a phased

retirement program be limited to employees who are eligible for immediately commencing retirement benefits under the plan (including those eligible for early retirement benefits). Other comments recommended that retirement benefits be permitted to start at a specific age or combination of age and service; however, they noted that current legislative constraints, notably the section 72(t) 10 percent additional income tax on early distributions, may limit the desirability of this option.

Some commentators advocated that any phased retirement arrangement should be cost neutral and not create additional funding obligations for employers. Others recommended that any early retirement subsidy available to an employee upon full retirement continue to be available if the employee participates in phased retirement. For example, one such commentator recommended not only that any early retirement subsidy be available upon phased retirement, but also that the subsidy so paid not be permitted to be applied to reduce the remainder of the benefit that is earned by the employee, particularly if the employee continues working past normal retirement age.

The comments were divided over what constituted phased retirement. Several recommended that phased retirement benefits be limited to cases in which there is a reduction in hours worked. Others recommended that a reduction in hours not be required and that a transition to a less stressful job also be considered phased retirement or that the full retirement benefit be payable after the attainment of a specified age or years of service without regard to any change in work.

The commentators who recommended that phased retirement benefits be limited to cases in which there is a reduction in hours worked generally recommended that the phased retirement benefits payable be proportionate to the reduction in work, based on a "dual status" approach. Under this dual status approach, an employee who reduces his or her work schedule to, for example, 80 percent of full-time would be considered to be 20 percent retired and thus entitled to 20 percent of his or her retirement benefit. The employee would continue to accrue additional benefits based on the actual hours he or she continues to work.

Several of the commentators discussed the implications of phased retirement benefits for purposes of the nondiscrimination rules of section 401(a)(4) and the anti-cutback rules of section 411(d)(6). Many of the comments said that phased retirement arrangements must be flexible and that

<sup>1</sup> See, for example, Pension & Welfare Benefits Administration, U.S. Department of Labor, "Report on Working Group on Phased Retirement to the Advisory Council on Employee Welfare & Pension Benefit Plans," 2000; Forman, Jonathan Barry, "How Federal Pension Laws Influence Individual Work and Retirement Decisions," 54 Tax Law. 143 (2000); Littler Mendelson, "Employers Consider 'Phased Retirement' to Retain Employees," Maryland Employment Law Letter, Vol 10, Issue 6 (April, 2000); Geisel, Jerry, "Rethinking Phased Retirement; IRS Call for Comment May Signal Pension Law Changes," Business Insurance (June 24, 2002); Flahaven, Brian, "Please Don't Go! Why Phased Retirement May Make Sense For Your Government," 18 Gov't Finance Review 24 (Oct. 1, 2002); NPR, Morning Edition, "Older Workers Turn to 'Phased' Retirement," (May 18, 2004) at [www.npr.org/features/feature.php?wfid=1900465](http://www.npr.org/features/feature.php?wfid=1900465).

it would be important for employers to be able to adopt a phased retirement arrangement on a temporary (even experimental) basis.

Many commentators expressed concern over the effect that a reduction in hours and the corresponding reduction in compensation would have on the final average pay of an individual for purposes of the benefit calculation when the employee fully retires. These comments generally requested guidance on this issue, including clarification as to whether an employee's final average pay is permitted to decline as a result of the employee's reduction in hours pursuant to participation in a phased retirement arrangement.

### Explanation of Provisions

#### Overview

The proposed regulations would amend § 1.401(a)-1(b) and add § 1.401(a)-3 in order to permit a pro rata share of an employee's accrued benefit to be paid under a bona fide phased retirement program. The pro rata share is based on the extent to which the employee has reduced hours under the program. Under this pro rata approach, an employee maintains a dual status (*i.e.*, partially retired and partially in service) during the phased retirement period. This pro rata or dual status approach to phased retirement was one of the approaches recommended by commentators.

While all approaches suggested by commentators were considered, the pro rata approach is the most consistent with the requirement that benefits be maintained primarily for retirement. Other approaches, such as permitting benefits to be fully available if an employee works reduced hours as part of phased retirement or permitting distributions of the entire accrued benefit to be paid as of a specified age prior to normal retirement age, are fundamentally inconsistent with the § 1.401(a)-1(b) principle that benefits be paid only after retirement. In addition, although a number of commentators suggested that guidance address the practice of terminating an employee with a prearranged rehiring of the employee (or similar sham transactions), the proposed regulations do not address this topic because it involves additional issues outside the scope of this project.

#### Rules Relating to Phased Retirement

Under the proposed regulations, a plan would be permitted to pay a pro rata portion of the employee's benefits under a bona fide phased retirement program before attainment of normal retirement age. The proposed

regulations define a bona fide phased retirement program as a written, employer-adopted program pursuant to which employees may reduce the number of hours they customarily work beginning on or after a retirement date specified under the program and receive phased retirement benefits. Payment of phased retirement benefits is permitted only if the program meets certain conditions, including that employee participation is voluntary and the employee and employer expect the employee to reduce, by 20 percent or more, the number of hours the employee works during the phased retirement period.

Consistent with the pro rata approach discussed above, the maximum amount that is permitted to be paid is limited to the portion of the employee's accrued benefit equal to the product of the employee's total accrued benefit on the date the employee commences phased retirement (or any earlier date selected by the plan for administrative ease) and the employee's reduction in work. The reduction in work is based on the employee's work schedule fraction, which is the ratio of the hours that the employee is reasonably expected to work during the phased retirement period to the hours that would be worked if the employee were full-time. Based in part on commentators' concerns regarding early retirement subsidies, the proposed regulations generally require that all early retirement benefits, retirement-type subsidies, and optional forms of benefit that would be available upon full retirement be available with respect to the phased retirement accrued benefit. However, the proposed regulations would not permit payment to be made in the form of a single-sum distribution (or other eligible rollover distribution) in order to prevent the premature distribution of retirement benefits. The phased retirement benefit is an optional form of benefit protected by section 411(d)(6) and the election of a phased retirement benefit is subject to the provisions of section 417, including the required explanation of the qualified joint and survivor annuity.

Some comments suggested that phased retirement be limited to employees who have attained an age or service (or combination thereof) that is customary for retirement, *e.g.*, where the employer has reasonably determined in good faith that participants who cease employment with the employer after that age or service combination are typically not expected to continue to perform further services of a generally comparable nature elsewhere in the workforce. Such a retirement age might

be considerably lower than age 65 in certain occupations (such as police or firefighters). As discussed further below (under the heading *Application to Plans Other Than Qualified Pension Plans*), the Treasury and IRS have concluded that they do not have the authority to permit payments to begin from a section 401(k) plan under a bona fide phased retirement program before the employee attains age 59½ or has a severance from employment.<sup>2</sup> Further, section 72(t)(3)(B) provides an additional income tax on early distributions if annuity distributions are made before the earlier of age 59½ or separation from service. Accordingly, in lieu of a customary retirement age, the proposed regulations adopt a rule that is consistent with section 401(k) and section 72(t)(3)(B), under which phased retirement benefits may not be paid before an employee attains age 59½.

#### Additional Accruals During Phased Retirement

The regulations provide that, during the phased retirement period, in addition to being entitled to the phased retirement benefit, the employee must be entitled to participate in the plan in the same manner as if the employee were still maintaining a full-time work schedule (including calculation of average earnings) and must be entitled to the same benefits (including early retirement benefits, retirement-type subsidies, and optional forms of benefits) upon full retirement as a similarly situated employee who has not elected phased retirement, except that the years of service credited under the plan for any plan year during the phased retirement period is multiplied by the ratio of the employee's actual hours of service during the year to the employee's full-time work schedule, or by the ratio of the employee's compensation to the compensation that would be paid for full-time work. Thus, for example, under a plan with a 1,000 hours of service requirement to accrue a benefit, an employee participating in a phased retirement program will accrue proportionate additional benefits, even if the employee works fewer than 1,000 hours of service.

The requirement that full-time compensation be imputed, with a proportionate reduction based on an employee's actual service, is intended to ensure that a participant is not disadvantaged by reason of choosing phased retirement. This rule precludes the need for extensive disclosure requirements, *e.g.*, disclosure to alert

<sup>2</sup> Cf., *Edwards v. Commissioner*, T.C. Memo. 1989-409, *aff'd*, 906 F.2d 114 (4th Cir. 1990).

participants to rights that may be lost as a result of participating in a phased retirement program. To be consistent with the requirement to use full-time compensation, the proposed regulations require an employee who was a highly compensated employee before commencing phased retirement to be treated as a highly compensated employee during phased retirement. See also § 1.414(q)-1T, A-4 & A-5.

Under the proposed regulations, the employee's final retirement benefit is comprised of the phased retirement benefit and the balance of the employee's accrued benefit under the plan (*i.e.*, the excess of the total plan formula benefit over the portion of the accrued benefit paid as a phased retirement benefit). Upon full retirement, the phased retirement benefit can continue unchanged or the plan is permitted to offer a new election with respect to that benefit.

This bifurcation is consistent with commentators' recommendation that an employee who is in a phased retirement program has a dual status, under which the employee is treated as retired to the extent of the reduction in hours and is treated as working to the extent of the employee's continued work with the employer. This approach also ensures that a phased retirement program offers an early retirement subsidy to the extent the employee has reduced his or her hours, and that the remainder of the employee's benefit rights is not adversely affected by participation in the phased retirement program.

#### *Testing and Adjustment of Payments*

Subject to certain exceptions, the proposed regulations require periodic testing to ensure that employees in phased retirement are in fact working at the reduced schedule, as expected. Thus, unless an exception applies, a plan must provide for an annual comparison between the number of hours actually worked by an employee during a testing period and the number of hours the employee was reasonably expected to work. If the actual hours worked during the testing period are materially greater than the expected number of hours, then the employee's phased retirement benefit must be reduced prospectively. For this purpose, the employee's hours worked are materially greater than the employee's work schedule if they exceed either 133 $\frac{1}{3}$  percent of the work schedule or 90 percent of the hours that the employee would work under a full-time schedule.

This annual comparison is not required after the employee is within 3 months of attaining normal retirement

age or if the amount of compensation paid to the employee by the employer during the phased retirement testing period does not exceed the compensation that would be paid to the employee if he or she had worked full time multiplied by the employee's work schedule fraction. Further, no comparison is required during the first year of an employee's phased retirement or if the employee has entered into an agreement with the employer that the employee will retire within 2 years.

In the event that the employer and employee agree to increase prospectively the hours that the employee will work, then the employee's phased retirement benefit must be adjusted based on a new work schedule. The date of the agreement to increase the employee's hours is treated as a comparison date for testing purposes.

In calculating the employee's benefit at full retirement, if an employee's phased retirement benefits have been reduced during phased retirement, the employee's accrued benefit under the plan is offset by an amount that is actuarially equivalent to the additional payments made before the reduction. The potential for this offset, like other material features of the phased retirement optional form of benefit, must be disclosed as part of the QJSA explanation as required under § 1.401(a)-20, Q&A-36, and § 1.417(a)(3)-1(c)(1)(v) and (d)(1).

If the employee's phased retirement benefit is less than the maximum amount permitted or the employee's work schedule is further reduced at a later date, the proposed regulations allow a plan to provide one or more additional phased retirement benefits to the employee. The additional phased retirement benefit, commencing a later annuity starting date, provides flexibility to reflect future reductions in the employee's work hours.

#### *Provisions Relating to Payment After Normal Retirement Age*

The proposed regulations clarify that a pension plan (*i.e.*, a defined benefit plan or money purchase pension plan) is permitted to pay benefits upon an employee's attainment of normal retirement age. However, normal retirement age cannot be set so low as to be a subterfuge to avoid the requirements of section 401(a), and, accordingly, normal retirement age cannot be earlier than the earliest age that is reasonably representative of a

typical retirement age for the covered workforce.<sup>3</sup>

#### *Application to Plans Other Than Qualified Pension Plans*

The regulations that limit distributions that are modified by these proposed regulations only apply to pension plans (*i.e.*, defined benefit or money purchase pension plans). Other types of plans may be subject to less restrictive rules regarding in-service distributions, including amounts held in or attributable to: (1) Qualified profit sharing and stock bonus plans to the extent not attributable to elective deferrals under section 401(k); (2) insurance annuities under section 403(b)(1), and retirement income accounts under section 403(b)(9), to the extent not attributable to elective deferrals; (3) custodial accounts under section 403(b)(7) to the extent not attributable to elective deferrals; and (4) elective deferrals under section 401(k) or 403(b). In general, these types of plans are permitted to provide for distributions after attainment of age 59 $\frac{1}{2}$ , without regard to whether the employee has retired or had a severance from employment. Accordingly, they may either provide for the same phased retirement rules that are proposed in these regulations or may provide for other partial or full in-service distributions to be available after attainment of age 59 $\frac{1}{2}$ . However, eligible governmental plans under section 457(b) are not generally permitted to provide for payments to be made before the earlier of severance from employment or attainment of age 70 $\frac{1}{2}$ . See generally § 1.457-6.

#### *Other Issues*

The proposed regulations also authorize the Commissioner to issue additional rules in guidance of general applicability regarding the coordination of partial retirement under a phased retirement program and the plan qualification rules under section 401(a).

These proposed regulations do not address all of the issues that commentators raised in response to Notice 2002-43. Thus, as noted above, the proposed regulations do not address when a full retirement occurs and specifically do not endorse a prearranged termination and rehire as constituting a full retirement. Further, the proposed regulations only address certain tax issues. For example, although commentators pointed out that

<sup>3</sup> While a low normal retirement age may have a significant cost effect on a traditional defined benefit plan, this effect is not as significant for defined contribution plans or for hybrid defined benefit plans.

the continued availability of health coverage would be an important feature for employees in deciding whether to participate in phased retirement, the proposed regulations do not include any rules relating to health coverage. Similarly, the proposed regulations do not address any potential age discrimination issues, other than through the requirement that participation in a bona fide phased retirement program be voluntary.

#### Proposed Effective Date

The rules in these regulations are proposed to apply to plan years beginning on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. These proposed regulations cannot be relied on before they are adopted as final regulations.

#### Special Analyses

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

#### Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. All comments will be available for public inspection and copying.

Comments are specifically requested on the following issues:

- Should eligibility to participate in a phased retirement program be extended to employees that reduce their workload using a standard, other than counting hours, to identify the reduction, and, if so, are there administrable methods for measuring the reduction?

- The proposed regulations require periodic testing of the hours an employee actually works during phased retirement, and if the hours are materially greater than the employee's

phased retirement work schedule, the phased retirement benefit must be adjusted. As discussed above (under the heading *Testing*), there are a number of exceptions to this requirement. Are there other, less complex alternatives that also would ensure that phased retirement benefits correspond to the employee's reduction in hours?

- The proposed regulations require an offset for the actuarial value of additional payments made before a reduction in phased retirement benefits. Should the regulations permit this offset to be calculated without regard to any early retirement subsidy and, if so, how should a subsidy be quantified?

- The proposed regulations clarify that the right to receive a phased retirement benefit as a partial payment is a separate optional form of benefit for purposes of section 411(d)(6) and, thus, is a benefit, right, or feature for purposes of the special nondiscrimination rules at § 1.401(a)(4)–4. Comments are requested on whether there are facts and circumstances under which the age and service conditions for a particular employer's phased retirement program should be disregarded in applying § 1.401(a)(4)–4 (even if the program may only be in place for a temporary period), or under which the rules at § 1.401(a)(4)–4 should otherwise be modified with respect to phased retirement.

- Should any special rules be adopted to coordinate the rules regarding distributions and continued accruals during phased retirement with a plan's provisions regarding employment after normal retirement age, such as suspension of benefits?

A public hearing may be scheduled if requested in writing by a person that timely submits written comments. If a public hearing is scheduled, notice of the date, time and place for the hearing will be published in the **Federal Register**.

#### Drafting Information

The principal author of these proposed regulations is Cathy A. Vohs 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 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

#### Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

## PART 1—INCOME TAXES

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

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

Section 1.401(a)–1 also issued under 26 U.S.C. 401.

Section 1.401(a)–3 also issued under 26 U.S.C. 401.

**Par. 2.** In § 1.401(a)–1, paragraph (b)(1)(i) is amended by adding text before the period at the end of the current sentence and a new second sentence, and paragraph (b)(1)(iv) is added to read as follows:

#### § 1.401(a)–1 Post-ERISA qualified plans and qualified trusts; in general.

\* \* \* \* \*

(b) \* \* \*

(1) \* \* \*

(i) \* \* \* or attainment of normal retirement age. However, normal retirement age cannot be set so low as to be a subterfuge to avoid the requirements of section 401(a), and, accordingly, normal retirement age cannot be earlier than the earliest age that is reasonably representative of a typical retirement age for the covered workforce.

\* \* \* \* \*

(iv) Benefits may not be distributed prior to normal retirement age solely due to a reduction in hours. However, notwithstanding anything provided elsewhere in paragraph (b) of this section (including the pre-ERISA rules under § 1.401–1), an employee may be treated as partially retired for purposes of paragraph (b)(1)(i) of this section to the extent provided under § 1.401(a)–3 relating to a bona fide phased retirement program.

\* \* \* \* \*

**Par. 3.** Section 1.401(a)–3 is added to read as follows:

#### § 1.401(a)–3 Benefits during phased retirement.

(a) *Introduction*—(1) *General rule.* Under section 401(a), a qualified pension plan may provide for the distribution of phased retirement benefits in accordance with the limitations of this paragraph (a) to the extent that an employee is partially retired under a bona fide phased retirement program, as defined in paragraph (c) of this section, provided the requirements set forth in paragraphs (d) and (e) of this section are satisfied.

(2) *Limitation on benefits paid during phased retirement period*—(i) *Benefits limited to pro rata retirement benefit.* The phased retirement benefits paid

during the phased retirement period cannot exceed the phased retirement accrued benefit payable in the optional form of benefit applicable at the annuity starting date for the employee's phased retirement benefit.

(ii) *Availability of early retirement subsidies, etc.* Except as provided in paragraph (a)(2)(iii) of this section, all early retirement benefits, retirement-type subsidies, and optional forms of benefit available upon full retirement must be available with respect to the portion of an employee's phased retirement accrued benefit that is payable as a phased retirement benefit.

(iii) *Limitation on optional forms of payment.* Phased retirement benefits may not be paid in the form of a single sum or other form that constitutes an eligible rollover distribution under section 402(c)(4).

(3) *Limited to full-time employees who are otherwise eligible to commence benefits.* Phased retirement benefits are only permitted to be made available to an employee who, prior to the phased retirement period, normally maintains a full-time work schedule and who would otherwise be eligible to commence retirement benefits immediately if he or she were to fully retire.

(4) *Authority of Commissioner to adopt other rules.* The Commissioner, in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(b) of this chapter), may adopt additional rules regarding the coordination of partial retirement under a phased retirement program and the qualification rules of section 401(a).

(b) *Definitions*—(1) *In general.* The definitions set forth in this paragraph (b) apply for purposes of this section.

(2) *Phased retirement program.* The term *phased retirement program* means a written, employer-adopted program pursuant to which employees may reduce the number of hours they customarily work beginning on or after a date specified under the program and commence phased retirement benefits during the phased retirement period, as provided under the plan.

(3) *Phased retirement period.* The term *phased retirement period* means the period of time that the employee and employer reasonably expect the employee to work reduced hours under the phased retirement program.

(4) *Phased retirement accrued benefit.* The term *phased retirement accrued benefit* means the portion of the employee's accrued benefit equal to the product of the employee's total accrued benefit on the annuity starting date for the employee's phased retirement

benefit, and one minus the employee's work schedule fraction.

(5) *Phased retirement benefit.* The term *phased retirement benefit* means the benefit paid to an employee upon the employee's partial retirement under a phased retirement program, based on some or all of the employee's phased retirement accrued benefit, and payable in the optional form of benefit applicable at the annuity starting date.

(6) *Work schedule.* With respect to an employee, the term *work schedule* means the number of hours the employee is reasonably expected to work annually during the phased retirement period (determined in accordance with paragraph (c)(4) of this section).

(7) *Full-time work schedule.* With respect to an employee, the term *full-time work schedule* means the number of hours the employee would normally work during a year if the employee were to work on a full-time basis, determined in a reasonable and consistent manner.

(8) *Work schedule fraction.* With respect to an employee, the term *work schedule fraction* means a fraction, the numerator of which is the employee's work schedule and the denominator of which is the employee's full-time work schedule.

(c) *Bona fide phased retirement program*—(1) *Definition generally.* The term *bona fide phased retirement program* means a phased retirement program that satisfies paragraphs (c)(2) through (5) of this section.

(2) *Limitation to individuals who have attained age 59½.* A bona fide phased retirement program must be limited to employees who have attained age 59½. A plan is permitted to impose additional requirements for eligibility to participate in a bona fide phased retirement program, such as limiting eligibility to either employees who have satisfied additional age or service conditions (or combination thereof) specified in the program or employees whose benefit may not be distributed without consent under section 411(a)(11).

(3) *Participation must be voluntary.* An employee's participation in a bona fide phased retirement program must be voluntary.

(4) *Reduction in hours requirement.* An employee who participates in a bona fide phased retirement program must reasonably be expected (by both the employer and employee) to reduce, by 20 percent or more, the number of hours the employee customarily works. This requirement is satisfied if the employer and employee enter into an agreement, in good faith, under which they agree that the employee will reduce, by 20

percent or more, the number of hours the employee works during the phased retirement period.

(5) *Limited to employees who are not key-employee owners.* Phased retirement benefits are not permitted to be made available to a key employee who is described in section 416(i)(1)(A)(ii) or (iii).

(d) *Conditions for commencement of phased retirement benefit*—(1) *Imputed accruals based on full-time schedule*—(i) *General rule.* During the phased retirement period, in addition to being entitled to payment of the phased retirement benefit, the employee must be entitled to participate in the plan in the same manner as if the employee still maintained a full-time work schedule (including calculation of average earnings, imputation of compensation in accordance with § 1.414(s)-1(f), and imputation of service in accordance with § 1.401(a)(4)-11(d)), and must be entitled to the same benefits (including early retirement benefits, retirement-type subsidies, and optional forms of benefits) upon full retirement as a similarly situated employee who has not elected phased retirement, except that the years of service credited under the plan for any plan year during the phased retirement period is determined under paragraph (d)(1)(ii) or (iii) of this section, whichever is applicable.

(ii) *Method for crediting years of service for full plan years.* The years of service credited under the plan for any full plan year during the phased retirement period is multiplied by an adjustment ratio that is equal to the ratio of the employee's actual hours worked during that year to the number of hours that would be worked by the employee during that year under a full-time work schedule. Alternatively, on a reasonable and consistent basis, the adjustment ratio may be based on the ratio of an employee's actual compensation during the year to the compensation that would be paid to the employee during the year if he or she had maintained a full-time work schedule.

(iii) *Method for crediting years of service for partial plan years.* In the case of a plan year only a portion of which is during a phased retirement period for an employee, the method described in paragraphs (d)(1)(i) and (ii) of this section is applied with respect to that portion of the plan year. Thus, for example, if an employee works full time until October 1 of a calendar plan year and works one-third time from October 1 through December 31 of the year, then the employee is credited with 10 months for that year (9 months plus  $\frac{1}{3}$  of 3 months).

(2) *Ancillary benefits during phased retirement period*—(i) *Death benefits.* If an employee dies while receiving phased retirement benefits, death benefits are allocated between the phased retirement benefit and the benefit that would be payable upon subsequent full retirement. See also § 1.401(a)–20, A–9. Thus, if an employee dies after the annuity starting date for the phased retirement benefit, death benefits are paid with respect to the phased retirement benefit in accordance with the optional form elected for that benefit, and death benefits are paid with respect to the remainder of the employee's benefit in accordance with the plan's provisions regarding death during employment.

(ii) *Other ancillary benefits.* To the extent provided under the terms of the plan, ancillary benefits, other than death benefits described in paragraph (d)(2)(i) of this section, are permitted to be provided during the phased retirement period.

(3) *Calculation of benefit at full retirement*—(i) *In general.* Upon full retirement following partial retirement under a phased retirement program, the employee's total accrued benefit under the plan (including the employee's accruals during the phased retirement period, determined in accordance with paragraph (d)(1) of this section) is offset by the portion of the employee's phased retirement accrued benefit that is being distributed as a phased retirement benefit at the time of full retirement.

(ii) *Adjustment for prior payments.* If, before full retirement, the employee's phased retirement benefit has been reduced under paragraph (d)(4) of this section, then the employee's accrued benefit under the plan is also offset upon full retirement by an amount that is actuarially equivalent to the phased retirement benefit payments that have been made during the phased retirement period that were not made with respect to the portion of the phased retirement accrued benefit that is applied as an offset under paragraph (d)(3)(i) of this section at the time of full retirement.

(iii) *Election of optional form with respect to net benefit.* Upon full retirement, an employee is entitled to elect, in accordance with section 417, an optional form of benefit with respect to the net accrued benefit determined under paragraph (d)(3)(i) and (ii) of this section.

(iv) *New election permitted for phased retirement benefit.* A plan is permitted to provide that, upon full retirement, an employee may elect, in accordance with section 417 and without regard to paragraph (a)(2)(iii) of this section, a new optional form of

benefit with respect to the portion of the phased retirement accrued benefit that is being distributed as a phased retirement benefit. Any such new optional form of benefit is calculated at the time of full retirement as the actuarial equivalent of the future phased retirement benefits (without offset for the phased retirement benefits previously paid).

(4) *Prospective reduction in phased retirement benefit if hours are materially greater than expected*—(i) *General rule.* Except as otherwise provided in this paragraph (d)(4), a plan must compare annually the number of hours actually worked by an employee during the phased retirement testing period and the number of hours the employee was reasonably expected to work during the testing period for purposes of calculating the work schedule fraction. For this purpose, the phased retirement testing period is the 12 months preceding the comparison date (or such longer period permitted under paragraph (d)(4)(iv) of this section, or any shorter period that applies if there is a comparison date as a result of an agreed increase under paragraph (d)(4)(vi) of this section). In the event that the actual hours worked (determined on an annual basis) during the phased retirement testing period exceeds the work schedule, then, except as provided in paragraph (d)(4)(ii) or (v) of this section, the employee's phased retirement benefit must be reduced in accordance with the method provided in paragraph (d)(4)(iii) of this section, effective as of an adjustment date specified in the plan that is not more than 3 months later than the comparison date.

(ii) *Permitted variance in hours.* A plan is not required to reduce the phased retirement benefit unless the hours worked during the phased retirement testing period are materially greater than the hours that would be expected to be worked under the work schedule. For this purpose, the employee's hours worked (determined on annual basis) are materially greater than the employee's work schedule if either—

(A) The employee's hours worked (determined on an annual basis) are more than 133 $\frac{1}{3}$  percent of the employee's work schedule; or

(B) The employee's hours worked (determined on an annual basis) exceed 90 percent of the full-time work schedule.

(iii) *Adjustment method.* If a phased retirement benefit must be reduced under paragraph (d)(4) of this section, a new (*i.e.*, reduced) phased retirement benefit must be calculated as provided

in this paragraph (d)(4)(iii). First, an adjusted work schedule is determined. The adjusted work schedule is an annual schedule based on the number of hours the employee actually worked during the phased retirement testing period. The adjusted work schedule is applied to the employee's accrued benefit that was used to calculate the prior phased retirement benefit. This results in a new phased retirement accrued benefit for purposes of paragraph (b)(4) of this section. Second, a new phased retirement benefit is determined, based on the new phased retirement accrued benefit and payable in the same optional form of benefit (*i.e.*, using the same annuity starting date and the same early retirement factor and other actuarial adjustments) as the prior phased retirement benefit. If an employee is receiving more than one phased retirement benefit (as permitted under paragraph (e)(2) of this section) and a reduction is required under paragraph (d)(4) of this section, then the reduction is applied first to the most recently commencing phased retirement benefit (and then, if necessary, to the next most recent phased retirement benefit, *etc.*).

(iv) *Comparison date for phased retirement testing period.* The comparison date is any date chosen by the employer on a reasonable and consistent basis and specified in the plan, such as the last day of the plan year, December 31, or the anniversary of the annuity starting date for the employee's phased retirement benefit. As an alternative to testing the hours worked during the 12 months preceding the comparison date, the plan may, on a reasonable and consistent basis, provide that the comparison of actual hours worked to the work schedule be based on a cumulative period that exceeds 12 months beginning with either the annuity starting date for the employee's phased retirement benefit or any later date specified in the plan.

(v) *Exceptions to comparison requirement*—(A) *In general.* The comparison of hours described in paragraph (d)(4) of this section is not required in the situations set forth in this paragraph (d)(4)(v).

(B) *Employees recently commencing phased retirement.* No comparison is required for an employee who commenced phased retirement benefits within the 12-month period preceding the comparison date.

(C) *Employees with short phased retirement periods.* No comparison is required during the first 2 years of an employee's phased retirement period if—

(1) The employee has entered into an agreement with the employer under which the employee's phased retirement period will not exceed 2 years and the employee will fully retire at the end of such period; and

(2) The employee fully retires after a phased retirement period not in excess of 2 years.

(D) *Employees with proportional pay reduction.* No comparison is required for any phased retirement testing period if the amount of compensation paid to the employee during that period does not exceed the compensation that would be paid to the employee if he or she had maintained a full-time work schedule multiplied by the work schedule fraction.

(E) *Employees at or after normal retirement age.* No comparison is required for any phased retirement testing period ending within 3 months before the employee's normal retirement age or any time thereafter.

(vi) *Agreement to increase hours—(A) General rule.* In the event that the employer and the employee agree to increase prospectively the hours under the employee's work schedule prior to normal retirement age, then, notwithstanding the exceptions provided in paragraphs (d)(4)(v)(B) through (D) of this section, the plan must treat the effective date of the agreement to increase the employee's hours as a comparison date for purposes of paragraph (d)(4)(iv) of this section. For purposes of this paragraph (d)(4)(vi), with respect to an employee, the term *new work schedule* means the greater of the actual number of hours the employee worked (determined on an annual basis) during the prior phased retirement testing period or the annual number of hours the employee reasonably expects to work under the new agreement.

(B) *Required adjustments.* If the employee's hours under the new work schedule are materially greater (within the meaning of paragraph (d)(4)(ii) of this section) than the hours the employee would be expected to work (based on the employee's prior work schedule), the employer is required to reduce the employee's phased retirement benefit, effective as of the date of the increase, based on the new work schedule. In this case, the employee's new work schedule is used for future comparisons under paragraph (d)(4) of this section.

(C) *Permitted adjustments.* If the employee's hours under the new work schedule are not materially greater (within the meaning of paragraph (d)(4)(ii) of this section) than the hours the employee would be expected to

work (based on the employee's prior work schedule), the employer is permitted, but not required, to reduce the employee's phased retirement benefit, effective as of the date of the increase, based on the new work schedule. If the benefit is so reduced, the employee's new work schedule is used for future comparisons under paragraph (d)(4) of this section. If the employee's phased retirement benefit is not so reduced, future comparisons are determined using the employee's prior work schedule.

(e) *Other rules—(1) Highly compensated employees.* An employee who partially retires under a phased retirement program and who was a highly compensated employee, as defined in section 414(q), immediately before the partial retirement is considered to be a highly compensated employee during the phased retirement period, without regard to the compensation actually paid to the employee during the phased retirement period.

(2) *Multiple phased retirement benefits permitted—(i) In general.* A plan is permitted to provide one or more additional phased retirement benefits prospectively to an employee who is receiving a phased retirement benefit if the conditions set forth in paragraph (e)(2)(ii) of this section are satisfied. At the later annuity starting date for the additional phased retirement benefit, the additional phased retirement benefits may not exceed the amount permitted to be paid based on the excess of—

(A) The employee's phased retirement accrued benefit at the later annuity starting date, over

(B) The portion of the employee's phased retirement accrued benefit at the earlier annuity starting date that is being distributed as a phased retirement benefit.

(ii) *Conditions.* The additional phased retirement benefit described in paragraph (e)(2)(i) of this section may be provided only if—

(A) The prior phased retirement benefit was not based on the employee's entire phased retirement accrued benefit at the annuity starting date for the prior phased retirement benefit, or

(B) The employee's work schedule at the later annuity starting date is less than the employee's work schedule that was used to calculate the prior phased retirement benefit.

(3) *Application of section 411(d)(6).* In accordance with § 1.411(d)-4, A-1(b)(1), the right to receive a partial distribution of an employee's accrued benefit as a phased retirement benefit is treated as an optional form of payment that is

separate from the right to receive a full distribution of the accrued benefit upon full retirement.

(4) *Application of nondiscrimination rules.* The right to receive a phased retirement benefit is a benefit, right, or feature that is subject to § 1.401(a)(4)-4.

(f) *Examples.* The following examples illustrate the application of this section:

*Example 1. (i) Employer's Plans.* Plan X (as in effect prior to amendment to reflect the phased retirement program described below) is a defined benefit plan maintained by Employer M. Plan X provides an accrued benefit of 1.5% of the average of an employee's highest three years of pay (based on the highest 36 consecutive months of pay), times years of service (with 1,000 hours of service required for a year of service), payable as a life annuity beginning at age 65. Plan X permits employees to elect to commence actuarially reduced distributions at any time after the later of termination of employment or attainment of age 50, except that if an employee retires after age 55 and completion of 20 years of service, the applicable reduction is only 3% per year for the years between ages 65 and 62 and 6% per year for the years between ages 62 to 55. Plan X permits employees to select, with spousal consent, a single life annuity, a joint and contingent annuity with the employee having the right to select any beneficiary and a continuation percentage of 50%, 75%, or 100%, or a 10-year certain and life annuity.

(ii) *Phased Retirement Program.* Employer M adopts a voluntary phased retirement program that will only be available for employees who retire during the two-year period from February 1, 2006 to January 31, 2008. The program will not be available to employees who are not entitled to an immediate pension or who are 1 percent owners. Employer M has determined that employees typically begin to retire after attainment of age 55 with at least 15 years of service. Accordingly, to increase retention of certain employees, the program will provide that employees in certain specified work positions who have reached age 59½ and completed 15 years of service may elect phased retirement. The program permits phased retirement to be implemented through a reduction of 25%, 50%, or 75% in the number of hours expected to be worked for up to 5 years following phased retirement (other reduced schedules may be elected with the approval of M), with the employee's compensation during the phased retirement period to be based on what a similar full-time employee would be paid, reduced by the applicable percentage reduction in hours expected to be worked. In order to participate in the program, the employee and the employer must enter into an agreement under which the employee will reduce his or her hours accordingly. The agreement also provides that the employee's compensation during phased retirement will be reduced by that same percentage. The program is announced to employees in the fall of 2005.

(iii) *Plan Provisions Regarding Phased Retirement Benefit.* (A) Plan X is amended, prior to February 1, 2006, to provide that an employee who elects phased retirement



under M's phased retirement program is permitted to commence benefits with respect to a portion of his or her accrued retirement benefit (the employee's phased retirement accrued benefit), based on the applicable percentage reduction in hours expected to be worked. For example, for a 25% reduction in hours, the employee is entitled to commence benefits with respect to 25% of his or her accrued benefit. Plan X permits an employee who commences phased retirement to elect, with spousal consent, from any of the optional forms provided under the plan.

(B) During the phased retirement period, the employee will continue to accrue benefits (without regard to the plan's 1,000 hour requirement), with his or her pay for purposes of calculating benefits under Plan X increased by the ratio of 100 percent to the percentage of full-time pay that will be paid during phased retirement and with the employee's service credit to be equal to the product of the same percentage times the service credit that would apply if the employee were working full time. Upon the employee's subsequent full retirement, his or her total accrued benefit will be based on the resulting highest three years of pay and total years of service, offset by the phased retirement accrued benefit. The retirement benefit payable upon subsequent full retirement is in addition to the phased retirement benefit. Plan X does not provide for a new election with respect to the phased retirement benefit.

(C) In the case of death during the phased retirement period, the employee will be treated as a former employee to the extent of his or her phased retirement benefit and as an active employee to the extent of the retirement benefit that would be due upon full retirement.

(D) Because the terms of the phased retirement program provide that the employee's compensation during phased retirement will be reduced by that same percentage as applies to calculate phased retirement benefits, Plan X does not have provisions requiring annual testing of hours actually worked.

(iv) *Application to a Specific Employee—*

(A) *Phased retirement benefit.* Employee E is age 59½ with 20 years of credited service. Employee E's compensation is \$90,000, and E's highest three years of pay is \$85,000. Employee E elects phased retirement on April 1, 2006 and elects to reduce hours by 50% beginning on July 1, 2006. Thus, E's annuity starting date for the phased retirement benefit is July 1, 2006. Employee E's total accrued benefit as of July 1, 2006 as a single life annuity payable at normal retirement age is equal to \$25,500 per year (1.5% times \$85,000 times 20 years of service). Thus, Employee E's phased retirement accrued benefit as of July 1, 2006 as a single life annuity payable at normal retirement age is equal to \$12,750 per year (\$25,500 times 1 minus E's work schedule fraction of 50%). Accordingly, Employee E's phased retirement benefit payable as a straight life annuity commencing on July 1, 2006 is equal to \$9,690 per year (\$12,750 per year times 76% (100% minus the applicable reduction for early retirement equal to 3% for 3 years and 6% for an additional 2½ years)).

Employee E elects a joint and 50% survivor annuity, with E's spouse as the contingent annuitant. Under Plan X, the actuarial factor for this form of benefit is 90%, so E's benefit is \$8,721 per year.

(B) *Death during phased retirement.* If Employee E were to die on or after July 1, 2006 and before subsequent full retirement, E's spouse would be entitled to a 50% survivor annuity based on the joint and 50% survivor annuity being paid to E, plus a qualified preretirement survivor annuity that complies with section 417 with respect to the additional amount that would be paid to E if he or she had fully retired on the date of E's death.

(C) *Subsequent full retirement benefit.* Three years later, Employee E fully retires from Employer M. Throughout this period, E's compensation has been 50% of the compensation that would have been paid to E if he or she were working full time. Consequently, no adjustment in E's phased retirement benefit is required. E's highest consecutive 36 months of compensation would be \$95,000 if E had not elected phased retirement and E has been credited with 1½ years of service credit for the 3 years of phased retirement (.50 times 3 years). Accordingly, prior to offset for E's phased retirement accrued benefit, E's total accrued benefit as of July 1, 2009 as a single life annuity commencing at normal retirement age is equal to \$30,637.50 per year (\$95,000 times 1.5% times 21.5 years of service) and, after the offset for E's phased retirement accrued benefit, E's retirement benefit as a single life annuity commencing at normal retirement age is equal to \$17,887.50 (\$30,637.50 minus \$12,750). Thus, the amount of E's additional early retirement benefit payable as a straight life annuity at age 62½ is equal to \$16,545.94 per year (\$17,887.50 per year times 92.5% (100% minus 3% for 2½ years)). Employee E elects, with spousal consent, a 10-year certain and life annuity that applies to the remainder of E's accrued benefit. This annuity is in addition to the previously elected joint and 50% survivor annuity payable as E's phased retirement benefit.

*Example 2. (i) Same Plan and Phased Retirement Program, Except Annual Testing Required.* The facts with respect to the Plan X and M's phased retirement program are the same as in *Example 1*, except that the program does not provide that the employee's compensation during phased retirement will be reduced by that same percentage as is applied to calculate phased retirement benefits, but instead the compensation depends on the number of hours worked by the employee. Plan X provides for annual testing on a calendar year basis and for an employee's phased retirement benefit to be reduced proportionately if the hours worked exceed a threshold, under provisions which reflect the variance permitted paragraph (d)(4)(ii) of this section.

(ii) *Employee Has Small Increase in Hours.* The facts with respect to Employee E are the same as in *Example 1*, except that E's full time work schedule would result in 2,000 hours worked annually, E's work schedule fraction is 50%, and E works 500 hours from

July 1, 2006 through December 31, 2006, 1,000 hours in 2007, 1,200 hours in 2008, and 600 hours from January 1, 2009 through E's full retirement on June 30, 2009.

(iii) *Application of Testing Rules.* No comparison of hours is required for the partial testing period that occurs in 2006. For 2007, no reduction is required in E's phased retirement benefit as a result of the hours worked by E during 2007 because the hours did not exceed E's work schedule (50% of 2,000). For 2008, although the hours worked by E exceeded E's work schedule, no reduction is required because the hours worked in 2008 were not materially greater than E's work schedule (1,200 is not more than the variance permitted under paragraph (d)(4)(ii) of this section, which is 133⅓% of 1,000). E's total accrued benefit upon E's retirement on July 1, 2009 would be based on 21.65 years of service to reflect the actual hours worked from July 1, 2006 through June 30, 2009.

*Example 3. (i) Same Plan and Phased Retirement Program, Except Material Increase in Hours.* The facts with respect to the Plan X and M's phased retirement program are the same as in *Example 2*, except E works 1,400 hours in 2008 and 700 hours in the first half of 2009.

(ii) *Application of Testing Rules.* No comparison of hours is required for the partial testing period that occurs in 2006. For 2007, no reduction is required in E's phased retirement benefit as a result of the hours worked by E during 2007 because the hours did not exceed 50% of 2,000. However, the hours worked by E during 2008 exceed 133⅓% of E's work schedule (50% of 2,000), so that the phased retirement benefit paid to E during 2009 must be reduced. The reduction is effective March 1, 2009. The new phased retirement benefit of \$5,232.60 is based on 30% of the participant's accrued benefit as of July 1, 2006, payable as a joint and 50% survivor annuity commencing on that date (30% times \$25,500 times the early retirement factor of 76% times the joint and 50% factor of 90%). This is equivalent to reducing the previously elected joint and 50% survivor annuity payable with respect to E by 40% (400 "excess" hours divided by the 1,000 hour expected reduction). When E retires fully on July 1, 2009, E's total accrued benefit as of July 1, 2009 as a single life annuity commencing at normal retirement age is \$31,065 per year (\$95,000 times 1.5% times 21.8 years of service). This accrued benefit is offset by (A) E's phased retirement accrued benefit (which is \$7,650 (600 divided by 2,000 times \$25,500)) plus (B) the actuarial equivalent of 40% of the payments that were made to E from January 1, 2008 through February 28, 2009.

*Example 4. (i) Same Plan and Phased Retirement Program, Except Employer and Employee Agree to Decrease Hours.* The facts with respect to the Plan X and M's phased retirement program are the same as in *Example 2*, except before 2008, E enters into an agreement with M to decrease E's number of hours worked from 50% of full time to 25% of full time. E works 500 hours in 2008 and 250 hours in 2009.

(ii) *Application of Multiple Benefit Rule.* Under paragraph (e)(2) of this section, Plan

M may provide for an additional phased retirement benefit to be offered to E for 2008. The maximum increase would be for the phased retirement benefit paid to E during 2009 to be increased based on a phased retirement accrued benefit equal to 75% of E's accrued benefit (1,500 divided by 2,000). Thus, the amount being paid to E would be increased, effective January 1, 2008, based on the excess of 75% of E's total accrued benefit on December 31, 2007, over E's original phased retirement accrued benefit of \$12,750. Employee E would have the right to elect, with spousal consent, any annuity form offered under Plan X (with the actuarial adjustment for time of commencement and form of payment to be based on the age of E and any contingent beneficiary (and E's service, if applicable) on June 1, 2008), which would be in addition to the previously elected joint and 50% survivor annuity payable as E's original phased retirement benefit. When E retires fully on July 1, 2009, Employee E's total accrued benefit as of July 1, 2009 would be offset by (A) E's original phased retirement accrued benefit plus (B) the phased retirement accrued benefit for which additional phased retirement benefits were payable beginning in 2008.

(g) *Effective date.* The rules of this section apply to plan years beginning on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

**Mark E. Matthews,**

*Deputy Commissioner for Services and Enforcement.*

[FR Doc. 04-24874 Filed 11-9-04; 8:45 am]

**BILLING CODE 4830-01-P**

## ENVIRONMENTAL PROTECTION AGENCY

### 40 CFR Part 52

[R05-OAR-2004-WI-0001; FRL-7829-5]

### Approval and Promulgation of Implementation Plans; Wisconsin

**AGENCY:** Environmental Protection Agency (EPA).

**ACTION:** Proposed rule.

**SUMMARY:** The EPA is proposing to approve revisions to Wisconsin's State Implementation Plan (SIP) regarding the control of nitrogen oxide (NO<sub>x</sub>) emissions. On August 29, 2003, the EPA published a final rulemaking approving the emission averaging program for existing sources subject to the state's rule limiting NO<sub>x</sub> emissions in southeast Wisconsin. By its submittal dated May 25, 2004, the Wisconsin Department of Natural Resources requested that EPA approve modifications to existing requirements regarding the control of NO<sub>x</sub> emissions in the Wisconsin SIP. The SIP revisions

modify language to clarify which sources are eligible to participate in the NO<sub>x</sub> emission averaging program. In addition, the revision creates a separate categorical emission limit for new combustion turbines burning biologically derived gaseous fuels. The request is approvable because it meets the requirements of the Clean Air Act. Wisconsin held a public hearing on the submittal on August 6, 2003.

In the final rules section of this **Federal Register**, EPA is approving the SIP revision as a direct final rule without prior proposal, because EPA views this as a noncontroversial revision and anticipates no adverse comments. A detailed rationale for the approval is set forth in the direct final rule. If no adverse comments are received in response to this proposed rule, no further activity is contemplated in relation to this proposed rule. If EPA receives adverse comments, EPA will withdraw the direct final rule and address all public comments received in a subsequent final rule based on this proposed rule. EPA will not institute a second comment period on this action. Any parties interested in commenting on this action should do so at this time.

**DATES:** Written comments must be received on or before December 10, 2004.

**ADDRESSES:** Submit comments, identified by Regional Material in EDocket ID No. R05-OAR-2004-WI-0001 by one of the following methods:  
*Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the on-line instructions for submitting comments.

*Agency Web site:* <http://docket.epa.gov/rmepub/index.jsp> material in EDocket(RME), EPA's electronic public docket and connect system, is EPA's preferred method for receiving comments. Once in the system, select "quick search" then key in the appropriate RME Docket identification number. Follow the on-line instructions for submitting comments.

*E-mail:* [bortzer.jay@epa.gov](mailto:bortzer.jay@epa.gov).

*Fax:* (312) 886-5824.

*Mail:* You may send written comments to: J. Elmer Bortzer, Chief, Air Programs Branch, (AR-18J), Environmental Protection Agency, 77 West Jackson Boulevard, Chicago, Illinois 60604.

*Hand delivery:* Deliver your comments to: J. Elmer Bortzer, Chief, Air Programs Branch (AR-18J), U.S. Environmental Protection Agency, Region 5, 77 West Jackson Boulevard, 18th floor, Chicago, Illinois 60604. Such deliveries are only accepted during the Regional Office's normal hours of

operation, which are Monday through Friday, 8:30 a.m. to 4:30 p.m. excluding Federal holidays.

*Instructions:* Direct your comments to the appropriate rulemaking by including in the text "Public comment on the proposed rulemaking Region 5 in Regional Material in EDocket ID No. R05-OAR-2004-WI-0001" in the subject line on the first page of your comment. EPA's policy is that all comments received will be included in the public docket without change, including any personal information provided, unless the comment includes information claimed to be Confidential Business Information (CBI) or other information whose disclosure is restricted by statute. Do not submit information that you consider to be CBI or otherwise protected through Regional Material in EDocket, [regulations.gov](http://regulations.gov), or e-mail. The EPA RME Web site and the Federal [regulations.gov](http://regulations.gov) Web site are "anonymous access" systems, which means EPA will not know your identity or contact information unless you provide it in the body of your comment. If you send an e-mail comment directly to EPA without going through RME or [regulations.gov](http://regulations.gov), your e-mail address will be automatically captured and included as part of the comment that is placed in the public docket and made available on the Internet. If you submit an electronic comment, EPA recommends that you include your name and other contact information in the body of your comment and with any disk or CD-ROM you submit. If EPA cannot read your comment due to technical difficulties and cannot contact you for clarification, EPA may not be able to consider your comment. Electronic files should avoid the use of special characters, any form of encryption, and be free of any defects or viruses. For additional instructions on submitting comments, go to Section I of the **SUPPLEMENTARY INFORMATION** section of this document.

*Docket:* All documents in the electronic docket are listed in the Regional Material in EDocket (RME) index at <http://www.epa.gov/edocket>. Although listed in the index, some information is not publicly available, *i.e.*, Confidential Business Information (CBI) or other information whose disclosure is restricted by statute. Publicly available docket materials are available either electronically in RME or in hard copy at Environmental Protection Agency, Region 5, Air and Radiation Division, 77 West Jackson Boulevard, Chicago, Illinois 60604. (We recommend that you telephone Charles Hatten, Environmental Engineer, at (312) 886-6031 before visiting the