

**DEPARTMENT OF THE TREASURY****Internal Revenue Service****26 CFR Parts 1 and 11**

[TD 9319]

RIN 1545-BD52

**Limitations on Benefits and Contributions Under Qualified Plans**

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

**ACTION:** Final regulations and removal of temporary regulations.

**SUMMARY:** This document contains final regulations under section 415 of the Internal Revenue Code (Code) regarding the limitations of section 415, including updates to the regulations for numerous statutory changes since comprehensive final regulations were last published under section 415. The final regulations also make conforming changes to regulations under sections 401(a), 401(a)(9), 401(k), 402, 416, and 457, and make other minor corrective changes to regulations under sections 401(a)(4), 414(s), 457, and 924. These regulations affect administrators of, participants in, and beneficiaries of qualified employer plans and certain other retirement plans.

**DATES:** *Effective Date:* These regulations are effective April 5, 2007.

*Applicability Dates:* These regulations generally apply for limitation years beginning on or after July 1, 2007. See §§ 1.401(k)-1(e)(8), 1.415(a)-1(g), 1.457-6(c)(2)(i), and 1.457-12 regarding the applicability dates of these regulations.

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**SUPPLEMENTARY INFORMATION:****Background**

This document contains amendments to the Income Tax Regulations (26 CFR Parts 1 and 11) under section 415 of the Code relating to limitations on benefits and contributions under qualified plans. In addition, this document contains conforming amendments to the Income Tax Regulations under sections 401(a) (including section 401(a)(9)), 401(k), 402, 416, and 457, as well as minor corrective changes to the regulations under section 457 and changes to other regulations under sections 401(a) (including section 401(a)(4)), 414(s), and 924 to update cross-references to the final regulations under section 415.

Section 415 was added to the Code by the Employee Retirement Income Security Act of 1974 (88 Stat. 829),

Public Law 93-406 (ERISA), and has been amended many times since. Section 415 provides a series of limits on benefits under qualified defined benefit plans and on contributions and other additions under qualified defined contribution plans. See also section 401(a)(16). Pursuant to section 415(a)(2), the limitations of section 415 also apply to section 403(b) annuity contracts and to simplified employee pensions described in section 408(k) (SEPs). In addition, the limitations of section 415 for defined contribution plans apply to contributions allocated to any individual medical account that is part of a pension or annuity plan established pursuant to section 401(h) and to amounts attributable to medical benefits allocated to an account under a welfare benefit fund established for a key employee pursuant to section 419A(d)(1).

Section 404(j) provides generally that, in computing the amount of any deduction for contributions under a qualified plan, benefits and annual additions in excess of the applicable limitations under section 415 are not taken into account. In addition, in computing the applicable limits on deductions for contributions to a defined benefit plan, and in computing the full funding limitation, an adjustment under section 415(d)(1) is not taken into account for any year before the year for which that adjustment first takes effect.

The definition of compensation that is used for purposes of section 415 is also used for a number of other purposes under the Code. Under section 219(b)(3), contributions on behalf of an employee to a plan described in section 501(c)(18) are limited to 25 percent of compensation as defined in section 415(c)(3). Section 404(a)(12) provides that, for various specified purposes in determining deductible limits under section 404, the term *compensation* includes amounts treated as participant's compensation under section 415(c)(3)(C) or (D). Pursuant to section 409(b)(3), for purposes of determining whether employer securities are allocated proportionately to compensation in accordance with the rules of section 409(b)(1), the amount of compensation paid to a participant for any period is the amount of such participant's compensation (within the meaning of section 415(c)(3)) for such period. Under section 414(q)(4), for purposes of determining whether an employee is a highly compensated employee within the meaning of section 414(q), the term compensation has the meaning given such term by section 415(c)(3). Section 414(s), which defines

the term compensation for purposes of certain qualification requirements, generally provides that the term compensation has the meaning given such term by section 415(c)(3). Under section 416(c)(2), allocations to participants who are non-key employees under a top-heavy plan that is a defined contribution plan are required to be at least 3 percent of the participant's compensation (within the meaning of section 415(c)(3)). Pursuant to section 457(e)(5), the term *includible compensation*, which is used in limiting the amount that can be deferred for a participant under an eligible deferred compensation plan as defined in section 457(b), has the same meaning as the term participant's compensation under section 415(c)(3).

Comprehensive regulations regarding section 415 were last issued in 1981. See TD 7748, published in the **Federal Register** on January 7, 1981 (46 FR 1687). Since then, changes to section 415 have been made in the Economic Recovery Tax Act of 1981, Public Law 97-34 (95 Stat. 320) (ERTA), the Tax Equity and Fiscal Responsibility Act of 1982, Public Law 97-248 (96 Stat. 623) (TEFRA), the Deficit Reduction Act of 1984, Public Law 98-369 (98 Stat. 494) (DEFRA), the Tax Reform Act of 1986, Public Law 99-514 (100 Stat. 2481) (TRA '86), the Technical and Miscellaneous Revenue Act of 1988, Public Law 100-647 (102 Stat. 3342) (TAMRA), the Uruguay Round Agreements Act of 1994, Public Law 103-465 (108 Stat. 4809) (GATT), the Small Business Job Protection Act of 1996, Public Law 104-188 (110 Stat. 1755) (SBJPA), the Community Renewal Tax Relief Act of 2000, Public Law 106-554 (114 Stat. 2763) (CRA), the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16 (115 Stat. 38) (EGTRRA), the Job Creation and Worker Assistance Act of 2002, Public Law 107-147 (116 Stat. 21) (JCWAA), the Pension Funding Equity Act of 2004, Public Law 108-218 (118 Stat. 596) (PFEA), the Working Families Tax Relief Act of 2004, Public Law 108-311 (118 Stat. 1166) (WFTRA), the Gulf Opportunity Zone Act of 2005, Public Law 109-135 (119 Stat. 2577) (GOZA), and the Pension Protection Act of 2006, Public Law 109-280 (120 Stat. 780) (PPA '06).

Although some limited changes to the regulations were made after 1981, most of the statutory changes made since that time are not reflected in the regulations, but in IRS notices, revenue rulings, and other guidance of general applicability, as follows:

- Notice 82-13 (1982-1 CB 360) (see § 601.601(d)(2)) provides guidance on

deductible employee contributions (including guidance under section 415) to reflect the addition of provisions relating to deductible employee contributions in ERTA.

- Notice 83-10 (1983-1 CB 536) (see § 601.601(d)(2)) provides guidance on the changes to section 415 made by TEFRA. The TEFRA changes were extensive, and included reductions of the dollar limits on annual benefits under a defined benefit plan and annual additions under a defined contribution plan, changes to the age and form adjustments made in the application of the limits under a defined benefit plan, and rules regarding the deductibility of contributions with respect to benefits that exceed the applicable limitations of section 415.

- Notice 87-21 (1987-1 CB 458) (see § 601.601(d)(2)) provides guidance on the changes to section 415 made by TRA '86. The TRA '86 changes modified the rules for the indexing of the dollar limit on annual additions under a defined contribution plan, the treatment of employee contributions as annual additions, and the rules for age adjustments under defined benefit plans, and added a phase-in of the section 415(b)(1)(A) dollar limitation over 10 years of participation, as well as rules permitting the limitations of section 415 to be incorporated by reference under the terms of a plan.

- Rev. Rul. 98-1 (1998-1 CB 249) (modifying and superseding Rev. Rul. 95-29, 1995-1 CB 81) (see § 601.601(d)(2)) provides guidance regarding certain form and age adjustments under a defined benefit plan pursuant to changes made by GATT (as modified under SBJPA), including transition rules relating to those adjustments.

- Notice 99-44 (1999-2 CB 326) (see § 601.601(d)(2)) provides guidance regarding the repeal under SBJPA of the limitation on the combination of a defined benefit plan and a defined contribution plan under former section 415(e).

- Notice 2001-37 (2001-1 CB 1340) (see § 601.601(d)(2)) provides guidance regarding the inclusion of salary reduction amounts for qualified transportation fringe benefits in the definition of compensation for purposes of section 415, as provided under CRA.

- Rev. Rul. 2001-51 (2001-2 CB 427) (see § 601.601(d)(2)) provides guidance relating to the increases in the limitations of section 415 for both defined benefit and defined contribution plans, which were enacted as part of EGTRRA.

- Rev. Rul. 2001-62 (2001-2 CB 632) (superseding Rev. Rul. 95-6, 1995-1 CB

80) (see § 601.601(d)(2)) provides mortality tables to be used to make certain form adjustments to benefits under a defined benefit plan for purposes of applying the limitations of section 415, pursuant to the requirement to use a specified mortality table added by GATT.

- Notice 2002-2 (2002-1 CB 285) (see § 601.601(d)(2)) provides guidance regarding the treatment of reinvested employee stock ownership plan (ESOP) dividends under section 415(c), to reflect changes made by SBJPA.

- Rev. Rul. 2002-27 (2002-1 CB 925) (see § 601.601(d)(2)) provides guidance pursuant to which a definition of compensation can be used for purposes of applying the limitations of section 415 even if that definition treats certain specified amounts that may not be available to an employee in cash as subject to section 125 (and therefore included in compensation).

- Rev. Rul. 2002-45 (2002-2 CB 116) (see § 601.601(d)(2)) provides guidance regarding the treatment of certain payments to defined contribution plans to restore losses resulting from actions by a fiduciary for which there is a reasonable risk of liability for breach of a fiduciary duty (including the treatment of those payments under section 415).

- Notice 2004-78 (2004-2 CB 879) (see § 601.601(d)(2)) provides guidance regarding the actuarial assumptions that must be used for distributions with annuity starting dates occurring during plan years beginning in years 2004 and 2005 to determine whether an amount payable under a defined benefit plan in a form that is subject to the minimum present value requirements of section 417(e)(3) satisfies the requirements of section 415. This guidance reflects changes made in PFEA.

For copies of recently issued Revenue Procedures, Revenue Rulings, Notices, and other guidance published in the Internal Revenue Bulletin or the Cumulative Bulletin, please visit the IRS Web site at <http://www.irs.gov>.

Some previously issued guidance has been superseded by subsequent statutory changes. For example, the simplified actuarial adjustment factors formerly permitted to be used to adjust certain forms of benefit for purposes of applying the limitations of section 415(b) pursuant to Rev. Rul. 80-253 (1980-2 CB 159) (see § 601.601(d)(2)) were not permitted to be used after statutory changes imposed the use of specified actuarial assumptions to make these adjustments. In addition, the projected post-retirement adjustments to the section 415(b)(1)(B) compensation limit that were required to be taken into

account for purposes of sections 404 and 412 under Rev. Rul. 81-195 (1981-2 CB 104) (see § 601.601(d)(2)) were not required or permitted to be taken into account for those purposes following the addition of section 404(j) in TEFRA.

The Treasury Department and the IRS believe that a single restatement of the section 415 rules serves the interests of plan sponsors, third-party administrators, plan participants, and plan beneficiaries. On May 31, 2005, a notice of proposed rulemaking (REG-130241-04) was published in the **Federal Register** (70 FR 31214) to issue new regulations under section 415 (the proposed regulations). The guidance items described in this preamble were reflected in the proposed regulations with some modifications. In addition, the proposed regulations reflected other statutory changes not previously addressed by guidance, and included some other changes and clarifications to the 1981 regulations. To the extent practicable, the preamble to the proposed regulations identified and explained substantive changes from the 1981 regulations or existing guidance.

Following publication of the proposed regulations, comments were received and a public hearing was held on August 17, 2005. Subsequently, Notice 2005-87 (2005-2 CB 1097) (see § 601.601(d)(2)) was issued to address certain concerns about the effective date provisions of the proposed regulations. After consideration of the comments received, the proposed regulations are adopted by this Treasury decision, subject to a number of changes that are summarized in the preamble.

## Explanation of Provisions

### Overview

These regulations reflect the numerous statutory changes to section 415 and related provisions that have been made since 1981. Some of the statutory changes reflected in the regulations are as follows:

- The current statutory limitations under sections 415(b)(1)(A) and 415(c)(1) applicable for defined benefit and defined contribution plans, respectively, as most recently amended by EGTRRA.

- Changes to the rules for age adjustments to the applicable limitations under defined benefit plans, under which the dollar limitation is adjusted for commencement before age 62 or after age 65.

- Changes to the rules, including specification of parameters, for benefit adjustments under defined benefit plans.

- The phase-in of the dollar limitation under section 415(b)(1)(A) over 10 years of participation, as added by TRA '86.
- The addition of the section 401(a)(17) limitation on compensation that is permitted to be taken into account in determining plan benefits, as added by TRA '86, and the interaction of this requirement with the limitations under section 415.
- Exceptions to the compensation-based limitation under section 415(b)(1)(B) for governmental plans and multiemployer plans.
- Changes to the aggregation rules under section 415(f) under which multiemployer plans are not aggregated with single-employer plans for purposes of applying the compensation-based limitation of section 415(b)(1)(B) to a single-employer plan.
- The repeal under SBJPA of the section 415(e) combined limitation on participation in a defined benefit plan and a defined contribution plan.
- The changes to section 415(c) that were made in conjunction with the repeal under EGTRRA of the exclusion allowance under section 403(b)(2).
- The current rounding and base period rules for annual cost-of-living adjustments pursuant to section 415(d), as most recently amended in EGTRRA and WFTRA.
- Changes to section 415(c) under which certain types of arrangements are no longer subject to the limitations of section 415(c) (such as individual retirement accounts other than SEPs) and other types of arrangements have become subject to the limitations of section 415(c) (such as certain individual medical accounts).
- The inclusion in compensation (for purposes of section 415) of certain salary reduction amounts not included in gross income.
- The modification for distributions with annuity starting dates in plan years beginning in years 2004 and 2005 made by PFEA with respect to the interest rate assumptions in section 415(b)(2)(E) for converting certain forms of benefits to an actuarially equivalent straight life annuity.
- The following modifications to section 415 that were made by PPA '06: (i) Changes to the interest rate assumptions in section 415(b)(2)(E) that are used for converting certain forms of benefits to an equivalent straight life annuity (section 303 of PPA '06); (ii) elimination of the active participation requirement in determining a participant's high-3 years of service in section 415(b)(3) (section 832 of PPA '06); (iii) exemption from the section 415(b)(1)(B) compensation limit for

certain benefits provided under a defined benefit plan maintained by an organization described in section 3121(w)(3)(A) (section 867 of PPA '06); and (iv) expansion of the definition of qualified participant in section 415(b)(2)(H) to include certain participants in a defined benefit plan maintained by an Indian tribal government (section 906(b) of PPA '06).

These regulations provide specific rules regarding when amounts received following severance from employment are considered compensation for purposes of section 415, and when such amounts are permitted to be deferred pursuant to section 401(k) or section 457(b). These regulations generally provide that amounts received following severance from employment are not considered to be compensation for purposes of section 415, but provide exceptions for certain payments made by the later of 2½ months following severance from employment or the end of the year in which the severance occurs. These regulations include corresponding changes to the regulations under sections 401(k) and 457 that provide that amounts payable following severance from employment can only be deferred if those amounts are within these same exceptions.<sup>1</sup> The rule pursuant to which compensation received after severance from employment is not considered compensation for purposes of section 415 generally does not apply to payments to an individual in qualified military service. The rules governing amounts received following severance from employment are discussed in this preamble in more detail under the paragraph heading “§ 1.415(c)-2: Definition of compensation.”

#### *Provisions of the Regulations*

##### *General Rules (§ 1.415(a)-1)*

Section 1.415(a)-1 of these regulations sets forth general rules relating to limitations under section 415 and provides an overview of the remaining regulations, including cross-references to special rules that apply to section 403(b) annuities, multiemployer plans, governmental plans, and plans that are not subject to the requirements of section 411. In addition, § 1.415(a)-1 provides rules for a plan's incorporation by reference of the rules of section 415 pursuant to section 1106(h) of TRA '86 (including detailed guidelines regarding

incorporation by reference of the annual cost-of-living adjustments to the statutory limits and the application of default rules), rules for plans maintained by more than one employer, a definition of the term “severance from employment,” and rules that apply in other special situations. Section 1.415(a)-1 generally retains the rules set forth in the proposed regulations.

The proposed regulations eliminated the rule under the 1981 regulations under which a multiemployer plan could satisfy the limitations of section 415 separately with respect to benefits or contributions from each employer. Thus, the proposed regulations required the benefits or annual additions with respect to a participant under a multiemployer plan to satisfy the limitations of section 415 on an aggregate basis. Some commentators asked that the rule from the 1981 regulations be retained. The IRS and the Treasury Department have determined that there is no statutory basis for permitting disaggregation of a multiemployer plan for this purpose. Furthermore, statutory changes made since the issuance of the 1981 regulations have made this permissive disaggregation rule from the 1981 regulations less needed and more conducive to significant abuses. In EGTRRA (and as made permanent in PPA '06), multiemployer plans were exempted from the limitation for defined benefit plans based on high-3 average compensation. This change eliminated the need for multiemployer plans to obtain compensation information with respect to each participant from multiple participating employers. In TRA '86, the phase-in period for the dollar limitation for defined benefit plans was changed from 10 years of service to 10 years of plan participation. As a result of this change, the permissive disaggregation rule from the 1981 regulations allows for the multiplication of section 415 limits within a multiemployer plan that could not be otherwise achieved by simply establishing separate single employer plans. Accordingly, these final regulations retain the rule from the proposed regulations that does not allow disaggregation of a multiemployer plan. In this regard, see the discussion under the paragraph heading “§ 1.415(c)-2: Definition of Compensation” for a rule that treats all employers contributing to a multiemployer plan as a single employer for purposes of the restriction on the recognition of compensation paid after severance from employment with an employer.

<sup>1</sup> The proposed regulations also contained corresponding changes to regulations under section 403(b) with respect to amounts payable following severance from employment. These changes will be incorporated into regulations under section 403(b) when those regulations are finalized.

Section 1.415(a)–1(d)(3)(v) provides rules regarding a plan's incorporation by reference of cost-of-living increases in the applicable limitations pursuant to section 415(d), including default rules that apply in the absence of contrary plan provisions. In providing rules for incorporation by reference, the proposed regulations provided that annual increases in the applicable limitations pursuant to section 415(d) do not apply in limitation years beginning after the annuity starting date to a participant who has previously commenced receiving benefits unless the plan specifies that this annual increase applies to such a participant.

One commentator pointed out that this provision in the proposed regulations modified the default treatment under the 1981 regulations (which provide that adjustments to the applicable limitations are not made after a participant's separation from service unless the plan so provides). In response to this comment, the final regulations retain the rule from the 1981 regulations under which the section 415(d) annual increases in the applicable limitations do not apply with respect to a participant for increases that become effective after the participant's severance from employment with the employer maintaining the plan (or, if earlier, after the annuity starting date in the case of a participant who has commenced receiving benefits) unless the plan specifies that this annual increase applies to such a participant. Thus, annual increases in the applicable limitations apply to a participant who has severed from employment with the employer maintaining the plan or who has commenced receiving benefits only if the plan specifies that those annual increases apply to such a participant.

#### Limitations Applicable to Defined Benefit Plans (§ 1.415(b)–1)

Section 1.415(b)–1 of these regulations sets forth rules for applying the limitations on benefits under a defined benefit plan. Under these limitations, the annual benefit must not exceed the lesser of \$160,000 (as adjusted pursuant to section 415(d)) and 100 percent of the participant's average compensation for the period of the participant's high-3 years of service. These regulations generally define the period of a participant's high-3 years of service as the period of 3 consecutive calendar years during which the employee had the greatest aggregate compensation from the employer. A retirement benefit payable in a form other than a straight life annuity is adjusted to an actuarially equivalent straight life annuity to determine the

annual benefit payable under that form of distribution. In addition, the \$160,000 dollar limitation under section 415(b)(1)(A) is actuarially adjusted for benefit payments that commence before age 62 or after age 65. Section 1.415(b)–1 generally retains the rules set forth in the proposed regulations except as indicated below.

The proposed regulations provided that, in addition to applying to benefits payable to participants and beneficiaries, the limitations of section 415(b) apply to accrued benefits (regardless of whether the benefit is vested) and benefits payable from an annuity contract distributed to a participant. Some commentators argued that it is inappropriate to apply the limitations of section 415(b) to a participant's accrued benefit in the case of a plan that is not subject to the requirements of section 411, since such a plan sometimes does not define an accrued benefit and benefits under such a plan can always be reduced if needed so that payments under the plan will satisfy the limitations of section 415. In response, these regulations provide that the rule applying section 415(b) to limit a participant's accrued benefit applies only to a plan that is subject to the requirements of section 411. However, a plan that is not subject to the requirements of section 411 is still subject to the requirements of section 415(b) with respect to the annual benefit payable to a participant at any time under the plan. As indicated in the preamble to the proposed regulations, where a participant's accrued benefit is computed pursuant to the fractional rule of section 411(b)(1)(C), the limitations of section 415(b) apply to the accrued benefit as of the end of the limitation year and, for ages prior to normal retirement age, are not required to be applied to the projected annual benefit commencing at normal retirement age from which the accrued benefit is computed.

#### A. Actuarial Assumptions Used to Convert Benefits to a Straight Life Annuity

Pursuant to section 415(b)(2)(B) (which provides for benefits paid in a form other than a straight life annuity to be adjusted to an actuarially equivalent straight life annuity in accordance with Treasury regulations), these regulations provide rules under which a retirement benefit payable in any form other than a straight life annuity is converted to the straight life annuity that is actuarially equivalent to that other form to determine the annual benefit (which is used to demonstrate compliance with section 415) with respect to that form of

distribution. These rules reflect statutory changes that specify the actuarial assumptions that are to be used for these equivalency calculations as well as published guidance that has been issued since the prior final regulations were published in 1981. The statutory changes reflected in these rules include, for plan years beginning in years 2004 and 2005, the use of a 5.5 percent interest rate for benefits that are subject to the present value rules of section 417(e)(3),<sup>2</sup> as set forth in PFEA, as well as the modifications under section 303 of PPA '06 to the equivalency calculations for benefits that are subject to the present value rules of section 417(e)(3) (which are applicable to distributions with annuity starting dates in plan years beginning after December 31, 2005). In addition to setting forth rules for adjusting forms of benefit other than straight life annuities, these regulations permit the IRS to issue published guidance setting forth simplified methods for making these adjustments.

Under these regulations, the annual benefit is determined as the greater of the actuarially equivalent straight life annuity determined under the plan's actuarial assumptions or the actuarially equivalent straight life annuity determined under actuarial assumptions specified by statute. This methodology implements the policy reflected in section 415(b)(2)(E), under which the plan's determination that a straight life annuity and a particular optional form of benefit are actuarially equivalent is overridden only when the optional form of benefit under the plan is more valuable than the corresponding straight life annuity when the two forms are compared using the statutorily specified actuarial assumptions.

The rules in these regulations under which a retirement benefit payable in any form other than a straight life annuity is converted to a straight life annuity to determine the annual benefit with respect to that form of distribution generally follow the rules set forth in Rev. Rul. 98–1. However, the calculation of the actuarially equivalent straight life annuity determined using the plan's assumptions for actuarial equivalence has been simplified for a

<sup>2</sup> Section 417(e)(3) provides minimum present value requirements for certain forms of benefit payable from a defined benefit plan under which payments cannot be less than the amount calculated using a specified interest rate and a specified mortality table. For forms of benefit that are subject to the minimum present value rules of section 417(e)(3), the limitations of section 415(b) apply to limit the amount of a distribution even if those limitations result in a lower distribution than would otherwise be required under the rules of section 417(e)(3). See § 1.417(e)–1(d)(1).

form of benefit that is not subject to the minimum present value rules of section 417(e)(3). Under the simplified calculation, instead of first determining the actuarial assumptions used under the plan and then applying those assumptions to convert an optional form of benefit to an actuarially equivalent straight life annuity, the regulations use the straight life annuity, if any, that is payable at the same age under the plan. This straight life annuity is then compared to the straight life annuity that is the actuarial equivalent of the optional form of benefit (determined using the standardized assumptions), and the larger of the two straight life annuities is used for purposes of demonstrating compliance with section 415.

This simplification has not been extended to forms of benefit that are subject to the minimum present value rules of section 417(e)(3), however, because under a plan those forms of benefit are often determined as the actuarial equivalent of the deferred annuity, rather than as the actuarial equivalent of the immediate straight life annuity. Instead, for a benefit paid in a form to which section 417(e)(3) applies, pursuant to section 415(b)(2)(E), the actuarially equivalent straight life annuity benefit generally is determined as the greatest of three annual amounts. The first is the annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using the interest rate and mortality table, or tabular factor, specified in the plan for actuarial equivalence. The second is the annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using a 5.5 percent interest assumption and the applicable mortality table for the distribution under § 1.417(e)-1(d)(2). The third is the annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable (computed using the applicable interest rate for the distribution under § 1.417(e)-1(d)(3) and the applicable mortality table for the distribution under § 1.417(e)-1(d)(2)), divided by 1.05. This rule reflects the amendment of section 415(b)(2)(E) by section 303 of PPA '06.

One commentator asked whether the rules regarding adjustments for forms of benefit that are subject to the minimum present value standards of section 417(e)(3) apply to plans that are not subject to the requirements of section

417. Section 415(b)(2)(E) applies based on the form of the benefit, and not the status of the plan, and therefore the final regulations provide that these rules also apply to plans that are not subject to the requirements of section 417.

Some commentators expressed concern that the examples illustrating the rules for actuarial adjustments converted optional forms of benefit into straight life annuities payable monthly, and they noted that had the conversion been to a straight life annuity payable on the first day of each year, the straight life annuity would have been smaller and therefore a greater benefit would have been permissible under section 415(b). Under section 415(b)(2)(B), the Secretary is delegated authority to prescribe regulations for adjusting a benefit so that it is equivalent to a benefit payable annually in the form of a straight life annuity. These regulations provide that if a benefit is payable in the form of a straight life annuity, no adjustment is made to account for differences in the timing of payments during a year (for example, no adjustment is made on account of the annuity being payable in annual or monthly installments). Thus, if the section 415(b) dollar limit for a limitation year is \$180,000, a plan is not permitted to provide for 12 monthly payments of \$15,583, which is actuarially equivalent to an annual benefit of \$180,000 payable on the first day of the year. With respect to a benefit payable in a form other than a straight life annuity, the annual benefit is determined as the straight life annuity payable on the first day of each month that is actuarially equivalent to the benefit payable in such other form.

Some commentators expressed concerns regarding the application of these actuarial adjustments in the case of annuity forms of benefit that are increased automatically each year pursuant to plan terms. Commentators argued that, in testing such a form of benefit for compliance with section 415, increases to the section 415(b) limits pursuant to section 415(d) should be taken into account. Thus, commentators asserted that a form of benefit with an automatic increase feature should satisfy section 415(b) so long as payments made pursuant to the benefit during each limitation year are less than the section 415(b) limit in effect for the limitation year.

In response to these comments, these final regulations provide that, for a form of benefit that is not subject to the requirements of section 417(e)(3), no adjustments are made to reflect these automatic increases if certain requirements are satisfied. Specifically,

the form of benefit without regard to the automatic increase feature must satisfy the requirements of section 415(b), and the plan must provide that in no event will the amount payable to a participant under the form of benefit in any limitation year be greater than the section 415(b) limit applicable at the annuity starting date, as increased in subsequent years pursuant to section 415(d). If these requirements are not satisfied, the annual benefit with respect to a benefit that is subject to automatic increases must reflect the value of these automatic increases under the rules described above.

#### *B. Inclusion of Social Security Supplements in Annual Benefit*

As under the proposed regulations, these regulations clarify that a social security supplement is included in determining the annual benefit. Under section 415(b)(2)(B), the annual benefit does not include ancillary benefits that are not directly related to retirement benefits. However, because a social security supplement is payable upon retirement as a form of retirement income, it is a retirement benefit. Thus, a social security supplement is included in determining the annual benefit without regard to whether it is an ancillary benefit or a qualified social security supplement (QSUPP) within the meaning of § 1.401(a)(4)-12.

#### *C. Determination of High-3 Average Compensation*

The proposed regulations contained two new provisions that would have had a significant effect on the determination of a participant's average compensation for the participant's high-3 consecutive years. The first provision changed a rule in the 1981 final regulations by restricting the compensation used for this purpose to compensation earned in periods during which the participant was an active participant in the plan. Pursuant to the amendment of section 415(b)(3) made by section 832 of PPA '06 (which eliminated the active participation requirement for purposes of determining average compensation for years beginning after December 31, 2005), this change has not been incorporated into the final regulations.

The second provision in the proposed regulations clarified the interaction of the requirements of section 401(a)(17) and the definition of compensation that must be used for purposes of determining a participant's average compensation for the participant's high-3 consecutive years. Because a plan is not permitted to base benefits on compensation in excess of the limitation

under section 401(a)(17), a plan's definition of compensation used for purposes of applying the limitations of section 415 is not permitted to reflect compensation in excess of the limitation under section 401(a)(17). Thus, for example, where a participant commences receiving benefits in 2006 at age 75 (so that the age-adjusted dollar limitation could be as high as \$390,953, depending on plan provisions), and the participant had compensation in excess of the applicable section 401(a)(17) limit for years 2003, 2004, and 2005, the participant's benefit under the plan is limited by the average compensation for his highest three years as limited by section 401(a)(17), which is \$205,000 (the average of \$200,000, \$205,000, and \$210,000).

Commentators objected to this second provision. These regulations retain this provision from the proposed regulations because the IRS and the Treasury Department believe that this interpretation is based on the best reading of applicable statutory requirements. However, these regulations include a grandfather provision under which a defined benefit plan is considered to satisfy the limitations of section 415(b) for a participant with respect to benefits accrued or payable under the plan as of the end of the limitation year that is immediately prior to the effective date of these final regulations for the plan pursuant to plan provisions (including plan provisions relating to the plan's limitation year) that were both adopted and in effect before April 5, 2007, but only if such plan provisions meet the requirements of statutory provisions, regulations, and other published guidance relating to section 415 in effect immediately before the effective date of these final regulations. In determining whether plan provisions meet the requirements of statutory provisions, regulations, and other published guidance relating to section 415 in effect immediately before the effective date of these final regulations, plan provisions are permitted to reflect compensation in excess of the section 401(a)(17) limit, and the benefits based on such compensation are eligible for the grandfather rules.

These regulations set forth rules for computing the limitation of section 415(b)(1)(B) of 100 percent of the participant's average compensation for the period of the participant's high-3 years of service for a participant who is employed with the employer for less than 3 consecutive calendar years. For such a participant, the period of the participant's high-3 years of service is the actual number of consecutive years

of service (including fractions of years, but not less than one year). In such a case, the limitation of section 415(b)(1)(B) of 100 percent of the participant's average compensation for the period of the participant's high-3 years of service is computed by averaging the participant's compensation during the participant's longest consecutive period of service over the actual period of service (including fractions of years, but not less than one year). In a change from the proposed regulations, these regulations provide that, in the case of a participant who has had a severance from employment with the employer maintaining the plan and who is subsequently rehired by that employer, the period of the participant's high-3 years of service is calculated by excluding any years for which the participant performs no services for and receives no compensation from the employer maintaining the plan (the break period), and by treating the year of service immediately prior to and the year of service immediately after the break period as if the years were consecutive.

These regulations also modify the proposed regulations by providing a rule that applies in the case of an employee who is rehired after severing employment. If the plan provides for the adjustment of a participant's compensation limit in accordance with section 415(d) for limitation years following the limitation year in which the employee severs employment, the rehired employee's compensation limit under section 415(b) is the greater of 100 percent of the participant's average compensation for the period of the participant's high-3 years of service, as determined prior to the employee's severance from employment and as adjusted pursuant to section 415(d), or 100 percent of the participant's average compensation for the period of the participant's high-3 years of service, taking into account service both before and after rehire. This rule was added because a participant's compensation limit should not be lower than it would otherwise be merely because the participant is rehired.

#### *D. Treatment of Benefits Paid Partially in the Form of a QJSA*

Under section 415(b)(2)(B), the survivor annuity portion of any joint and survivor annuity that constitutes a qualified joint and survivor annuity (QJSA), as defined in section 417(b), is not taken into account in determining the annual benefit for purposes of applying the limitations of section 415(b). As under the proposed

regulations, these regulations clarify how this exception from the limitations of section 415 for the survivor annuity portion of a QJSA applies to benefits paid partially in the form of a QJSA and partially in some other form. Under this clarification, the rule excluding the survivor portion of a QJSA from the annual benefit applies to the survivor annuity payments under the portion of a benefit that is paid in the form of a QJSA, even if another portion of the benefit is paid in some other form.

#### *E. Dollar Limitation Applicable to Early or Late Commencement*

The determination of the age-adjusted dollar limitation under these regulations reflects the rules enacted in EGTRRA. As provided in Q&A-3 of Rev. Rul. 2001-51, this determination generally follows the same steps and procedures as those used in Rev. Rul. 98-1, except that such determination takes into account the increased defined benefit dollar limitation enacted by EGTRRA and the adjustments for early or late commencement are no longer based on social security retirement age. Applying rules that are similar to those that are used for determining actuarial equivalence among forms of benefits, these regulations generally use the plan's determinations for actuarial equivalence of early or late retirement benefits, but override those determinations where the use of the specified statutory assumptions results in a lower limit. This methodology is retained from the proposed regulations because the IRS and the Treasury Department believe that generally a plan's actuarial equivalence for section 415 purposes should be the same as actuarial equivalence for other purposes and because of the need to have an administrable rule when a plan uses factors that are not explicitly based on an interest rate and mortality table.

Some commentators expressed concern that these rules effectively result in no increase to the dollar limitation where a plan that is not subject to the requirements of section 411 does not increase the participant's benefit to reflect a delay in commencement beyond age 65. No change has been made to address this concern because the IRS and the Treasury Department believe it is not appropriate to increase the dollar limitation for commencement after age 65 where, under the plan terms, there is no increase to the participant's benefit on account of delayed commencement (so that any increase in a participant's benefit is solely on account of additional service or compensation). In response to other commentator

concerns, these regulations provide that an actuarial increase to a participant's benefit for commencement after age 65 is taken into account for this purpose even if the actuarial increase offsets additional benefit accruals under the plan.

These regulations adopt rules for mortality adjustments used in computing the dollar limitation on a participant's annual benefit for distributions commencing before age 62 or after age 65 that are generally consistent with Notice 83-10 and Notice 87-21. Under these rules, to the extent that a forfeiture does not occur upon the participant's death before the annuity starting date, generally no adjustment is made to reflect the probability of the participant's death during the relevant time period (which is the period before age 62 or after age 65), and to the extent a forfeiture occurs upon the participant's death before the annuity starting date, an adjustment must be applied to reflect the probability of the participant's death during the relevant time period.

These regulations also provide a simplified method for applying these mortality adjustment rules. Under this simplified method, a plan is permitted to treat no forfeiture as occurring upon a participant's death if the plan does not charge participants for providing a qualified preretirement survivor annuity, but only if the plan applies this treatment for adjustments that apply both before age 62 and after age 65. This simplified method eliminates the need to determine the extent of a forfeiture upon death in the case where a plan provides for a qualified preretirement survivor annuity.

One commentator asked whether, for purposes of adjusting the dollar limit for commencement prior to age 62, a plan is permitted to make a mortality adjustment for ages below age 62, even if the plan does not provide for a forfeiture upon the participant's death before the annuity starting date where it is before age 62. Recognizing that mortality adjustments would result in a lower limit in such a case, these regulations permit such an adjustment to be made if the plan so provides.

Some commentators expressed concern that the application of the rules that adjust the section 415(b)(1)(A) dollar limit for pre-age 62 benefit commencement as set forth in the proposed regulations could result in the limit decreasing as a participant ages under certain circumstances. To address this concern, these regulations provide that, notwithstanding the generally applicable rules for age adjustments to the dollar limitation, the age-adjusted

section 415(b)(1)(A) dollar limit does not decrease on account of an increase in age or the performance of additional service.

*F. Nonapplication of Adjustment to Dollar Limitation for Early Commencement With Respect to Police Department and Fire Department Employees*

Consistent with section 415(b)(2)(G) and (H), as amended by section 906(b) of PPA '06, these regulations provide that the early retirement reduction does not apply to certain participants in plans of state, Indian tribal government, and local government units who are employees of a police department or fire department, or former members of the Armed Forces of the United States. This rule applies to any participant in a plan maintained by a state, Indian tribal government, or political subdivision thereof who is credited, for benefit accrual purposes, with at least 15 years of service as either (1) a full-time employee of any police department or fire department of the state, Indian tribal government, or political subdivision that provides police protection, firefighting services, or emergency medical services, or (2) a member of the Armed Forces of the United States. These regulations clarify that the application of this rule depends on whether the employer is a police department or fire department of the state, Indian tribal government, or political subdivision, rather than on the job classification of the individual participant. Also, this rule applies based on the function of an organization rather than based on the name of the organization.

*G. Application of \$10,000 Exception*

Pursuant to section 415(b)(4), the benefits payable with respect to a participant under a defined benefit plan satisfy the limitations of section 415(b) if the retirement benefits payable with respect to such a participant under the plan and all other defined benefit plans of the employer do not exceed \$10,000 for the plan year or for any prior plan year, and the employer has not at any time maintained a defined contribution plan in which the participant participated. As under the proposed regulations, these regulations clarify that the alternative \$10,000 limitation under section 415(b)(4) is applied to actual distributions made during each year. Thus, a distribution for a limitation year that exceeds \$10,000 is not within the section 415(b)(4) alternative limitation (and therefore will not be excepted from the otherwise applicable limits of section 415(b)), even

if the distribution is a single-sum distribution that is the actuarial equivalent of an accrued benefit with annual payments that are less than \$10,000.

*H. Exclusion of Annual Benefit Attributable to Mandatory Employee Contributions From Annual Benefit*

These regulations retain the rules from the 1981 regulations that the annual benefit does not include the annual benefit attributable to mandatory employee contributions. For this purpose, the term *mandatory employee contributions* means amounts contributed to the plan by the employee that are required as a condition of employment, as a condition of participation in the plan, or as a condition of obtaining benefits (or additional benefits) under the plan attributable to employer contributions. See section 411(c)(2)(C). Employee contributions to a defined benefit plan that are not maintained in a separate account as described in section 414(k) constitute mandatory employee contributions (even if an employee can elect whether to make the contributions, and even if section 411 does not apply to the plan) because, depending upon the investment performance of plan assets, employer contributions may be needed to pay the portion of the participant's benefit that is conditioned upon these employee contributions. Any other employee contributions (plus earnings thereon) are treated as a separate defined contribution plan rather than as part of a defined benefit plan.

These regulations retain the rule from the 1981 regulations that the annual benefit attributable to mandatory employee contributions is determined under the rules of section 411(c) and regulations promulgated under section 411, regardless of whether section 411 applies to the plan. These regulations also clarify that the following are not treated as employee contributions: (1) Contributions that are picked up by a governmental employer as provided under section 414(h)(2), (2) repayment of any loan made to a participant from the plan, and (3) repayment of any amount that was previously distributed. One commentator asked how to determine the annual benefit attributable to mandatory employee contributions under section 411(c) in the case of a plan that is not subject to the requirements of section 411 and 417, and suggested the use of the plan's factors for this purpose. This suggestion was not incorporated into these final regulations because the amount payable with respect to employee contributions



that is in excess of the amount that would be payable with respect to such contributions using the rules of section 411(c) is effectively a subsidy that should be included in determining the participant's annual benefit under the plan. These regulations also provide that, for purposes of determining the accumulated contributions described in section 411(c)(2)(C), where the plan is not subject to the requirements of section 411, the plan must determine what would have been the applicable effective date of section 411(a)(2) as if section 411 applied to the plan, and in determining the annual benefit that is actuarially equivalent to these accumulated contributions, the plan must determine the interest rate that would have been required under section 417(e)(3) as if section 417 applied to the plan.

Another commentator asked why the repayment of an employee contribution is not treated as an employee contribution under this rule. No change to the regulations has been made to reflect this concern because, while the repayment is not treated as an employee contribution for purposes of section 415, the original employee contribution is still considered an employee contribution for this purpose.

#### *I. Exclusion of Annual Benefit Attributable to Rollover Contributions From Annual Benefit*

These regulations clarify that the annual benefit does not include the annual benefit attributable to rollover contributions made to a defined benefit plan (that is, rollover contributions that are not maintained in a separate account that is treated as a separate defined contribution plan under section 414(k)). In such a case, the annual benefit attributable to rollover contributions is determined by applying the rules of section 411(c) and treating the rollover contributions as employee contributions (regardless of whether sections 411 and 417 apply to the plan). This will occur, for example, if a distribution is rolled over from a defined contribution plan to a defined benefit plan to provide an annuity distribution. Thus, in the case of rollover contributions from a defined contribution plan to a defined benefit plan to provide an annuity distribution, the annual benefit attributable to those rollover contributions for purposes of section 415 is determined by applying the rules of section 411(c), regardless of the assumptions used to compute the annuity distribution under the plan. Accordingly, in such a case, if the plan credits higher interest or uses more favorable factors than those specified in section 411(c) to determine the amount

of annuity payments arising from a rollover contribution, the annual benefit under the plan reflects the excess of those annuity payments over the amounts that would be payable using the rules of section 411(c) because such excess is effectively a subsidy which is included in determining the participant's annual benefit under the plan.

These final regulations clarify that the rule that excludes the annual benefit attributable to rollover contributions applies to rollover contributions from an eligible retirement plan, as defined in section 402(c)(8)(B). Thus, the rule applicable to rollovers is not limited solely to rollovers from qualified plans.

Rollover contributions to an account that is treated as a separate defined contribution plan under section 414(k) do not give rise to an annual benefit because the separate account is not treated as a defined benefit plan under section 415(b). Furthermore, under the rules relating to defined contribution plans, these rollover contributions to a separate account are excluded from the definition of annual additions to a defined contribution plan.

#### *J. Treatment of Benefits Transferred Among Plans and Terminated Plans*

These regulations generally retain the provisions in the proposed regulations that modify the rules of the 1981 final regulations for determining the amount of transferred benefits that are excluded from the annual benefit under a defined benefit plan in the event of a transfer from another defined benefit plan. These modifications to the 1981 final regulations are designed to ensure that transferred benefits are not counted more than once when the transferor plan and the transferee plan are aggregated under section 415(f) and § 1.415(f)-1, and to prevent the circumvention of the limitations of section 415(b) through benefit transfers to plans of unrelated employers. The rules of section 415(b) that apply upon a transfer of benefits between plans operate independently from the requirements of section 414(l), and compliance with the requirements of section 414(l) does not ensure compliance with these rules.

The proposed regulations provided that, if the transferee plan's benefits are required to be taken into account pursuant to section 415(f) and § 1.415(f)-1 in determining whether the transferor plan satisfies the limitations of section 415(b) for that limitation year, then the transferred benefits are disregarded in determining the annual benefit under the transferor plan. The final regulations modify this rule. This

modification is being made in conjunction with modifications to the proposed regulations with respect to the aggregation of plans among formerly affiliated employers (discussed in more detail under the heading “§ 1.415(f)-1: Aggregating plans”). Generally, under the modified section 415(f) aggregation rules, there are situations in which only a portion of the benefits provided under plans maintained by formerly affiliated employers is taken into account when applying section 415 on an aggregated basis to each employer. Given this modification to the aggregation rules, the determination of whether transferred benefits are nonetheless treated as provided by the transferor plan is properly based on whether the transferred benefits are included in the portion of the transferee plan that is aggregated with the transferor plan. Thus, the final regulations provide that, to the extent the benefits transferred to a transferee plan are otherwise required to be taken into account pursuant to section 415(f) and § 1.415(f)-1 in determining whether the transferor plan satisfies the limitations of section 415(b), the transferred benefits are not also treated as being provided under the transferor plan (because these benefits will be taken into account by the transferor plan when it is aggregated with the transferee plan).

The proposed regulations provided that where there has been a transfer of liabilities between plans and the transferee plan's benefits are not required to be taken into account pursuant to section 415(f) and § 1.415(f)-1 in determining whether the transferor plan satisfies the limitations of section 415(b), the assets associated with those transferred liabilities (other than surplus assets) are treated by the transferor plan as distributed as a single-sum distribution. These final regulations modify this proposed transfer rule in two respects. First, for the reasons described in the paragraph above, this transfer rule is applicable only if the benefits transferred to the transferee plan are not otherwise required to be taken into account by the transferor plan pursuant to section 415(f) and § 1.415(f)-1. Second, the final regulations modify this proposed rule in response to comments expressing concern with the administrative complexity associated with the calculation of the deemed single-sum distribution. Instead of treating the assets associated with the transferred liabilities as a deemed single-sum distribution, the final regulations treat the transferred liabilities as comprising a plan that must be aggregated with the



transferor plan, that had terminated with sufficient assets to pay benefit liabilities under the plan and had purchased annuities to provide plan benefits.

Although such a transfer is treated as a plan termination in computing the annual benefit under the transferor plan, no corresponding adjustment to the annual benefit under the transferee plan is made to reflect the fact that some of the benefits provided under the transferee plan are attributable to the transfer. Thus, the actual benefit provided under the transferee plan is used to determine the annual benefit under the transferee plan even though the transferred amount is also included along with other benefits provided under the transferor plan in determining the participant's annual benefit under the transferor plan.

While some commentators expressed concern that this resulted in double counting of benefits, in most such cases, a participant whose benefits have been transferred would accrue no additional benefit under the transferor plan that would be required to be tested under the transferor plan (in combination with the transferred benefits). Furthermore, these rules prevent the transferor plan from avoiding the limitations of section 415 for participants by spinning off the participants' benefits to a plan of an unrelated employer and then accruing additional benefits for the participants. For example, without these rules, the benefit of an executive in a plan maintained by the executive's employer could be transferred to a plan maintained by a business that is owned by the executive and that is not aggregated with the executive's employer for purposes of section 415, and the executive could accrue an additional benefit up to the section 415 limits under the plan maintained by the executive's employer.

The final regulations provide rules specifying how to take into account benefits provided under a terminated plan. If a defined benefit plan is terminated with sufficient assets to pay accrued benefits and a participant in the plan has not yet commenced benefits under the plan, for purposes of satisfying section 415(b) with respect to the participant, the final regulations require that all other defined benefit plans maintained by the employer that maintained the terminated plan take into account the benefits provided pursuant to the annuities purchased to provide benefits under the terminated plan at each possible annuity starting date. The final regulations provide that if a defined benefit plan is terminated and there are not sufficient assets for the

payment of the accrued benefit of all plan participants, all other defined benefit plans maintained by the employer that maintained the terminated plan are required to take into account the benefits that are actually provided under the terminated plan. For example, if the terminated plan is subject to Title IV of ERISA, the other plans maintained by the employer that maintained the terminated plan take into account the benefits that are provided by the Pension Benefit Guaranty Corporation. If the terminated plan was not subject to Title IV of ERISA, the other plans take into account the benefits that are actually paid by the terminated plan. The multiple annuity starting date rules apply to the extent that benefits from a terminated plan and an ongoing plan do not commence at the same time.

These regulations clarify that if a participant elects to transfer a distributable benefit to a defined benefit plan pursuant to § 1.411(d)-4, A-3(c), the transfer is treated in the same manner as an amount that is distributed and then rolled over (specifically, the transferred benefit is treated by the transferor plan as a distribution, and the annual benefit provided by the transferee plan does not include the annual benefit attributable to the amount transferred). This rule applies regardless of whether the requirements of section 411 apply to the plan and, in the case of a transfer from a defined contribution plan that is not subject to the requirements of section 411 (such as a governmental plan) to a defined benefit plan, the rule applies even if the participant's benefits are not distributable from the defined contribution at the time of the transfer.

#### *K. 10-Year Phase-in of Limitations Based on Years of Participation and Years of Service*

As under the proposed regulations, these regulations provide rules for applying the 10-year phase-in of the dollar limitation based on years of participation in the plan, as added by TRA '86, and modify the rules set forth in the 1981 regulations for applying the 10-year phase-in of the compensation limit based on years of service. These regulations, like the proposed regulations, follow the guidance set forth in Notice 87-21 for applying the 10-year phase-in based on years of participation, and apply analogous rules for purposes of applying the 10-year phase-in based on years of service.

#### *L. Exception to Compensation-Based Limit for Certain Church Plans*

The final regulations also reflect the amendment of section 415(b)(11) by PPA '06. Under the amendment, the section 415(b)(1)(B) compensation-based limit that is generally applicable to defined benefit plans is not applicable to a participant in a plan maintained by a church described in section 3121(w)(3)(A) if the participant has never been a highly compensated employee (as defined in section 414(q)) of the church. These regulations provide that if such a participant later becomes a highly compensated employee of the church, the plan is not treated as failing to satisfy the compensation-based limit provided that no plan amendments increasing the participant's benefits are adopted in the year the participant becomes a highly compensated employee and there is no increase in the participant's accrued benefit derived from employer contributions in subsequent years.

#### *Multiple Annuity Starting Dates (§ 1.415(b)-2)*

Section 1.415(b)-2 of the proposed regulations set forth rules for computing the annual benefit under one or more defined benefit plans in the case of multiple annuity starting dates. Multiple annuity starting dates exist, for example, where benefit distributions to a participant have previously commenced under a plan that is aggregated for purposes of section 415 with a plan for which the participant receives current accruals. In addition, the multiple annuity starting date rules apply for purposes of determining the annual benefit of a participant where a new distribution election is effective during the current limitation year with respect to a distribution that previously commenced. The multiple annuity starting date rules also apply when benefit payments are increased, unless the benefit increase complies with one of the safe harbors provided in the regulations.

Numerous commentators raised concerns regarding these rules. Based on these comments, the IRS and the Treasury Department have determined that revisions to these rules are needed before these rules are adopted in final form. Accordingly, these regulations reserve a place for regulations regarding multiple annuity starting dates. The IRS and the Treasury Department are developing new proposed regulations regarding multiple annuity starting dates, and corresponding revisions to regulations under § 1.401(a)(9)-6.

In the interim, § 1.415(b)-1 of these regulations provides that if a participant has or will have distributions commencing at more than one annuity starting date, the limitations of section 415 must be satisfied as of each of the annuity starting dates, taking into account the benefits that have been or will be provided at all of the annuity starting dates. In determining the annual benefit of a participant as of a particular annuity starting date, the plan is required to actuarially adjust past and future distributions with respect to the benefit that commenced at the other annuity starting dates.

#### Limitations Applicable to Defined Contribution Plans § 1.415(c)-1

Section 1.415(c)-1 of these regulations sets forth rules that apply to limitations on annual additions under a defined contribution plan. Under these limitations, annual additions must not be greater than the lesser of \$40,000 (as adjusted pursuant to section 415(d)) or 100 percent of the participant's compensation for the limitation year. The term *annual additions* generally means the sum for any year of employer contributions, employee contributions, and forfeitures. In addition to applying to qualified defined contribution plans, the limitations in section 415(c) and § 1.415(c)-1 of the regulations apply to section 403(b) annuity contracts, simplified employee pensions described in section 408(k), mandatory employee contributions to qualified defined benefit plans, and contributions to certain medical benefit accounts.

These regulations reflect a number of statutory changes to section 415(c) that were made after the issuance of the 1981 regulations. Among these changes are the revised limitation amounts under section 415(c), the revised rules applicable to employee stock ownership plans, and the rules applying the limitations of section 415(c) to certain medical benefit accounts. These regulations also make some other changes to the 1981 regulations, as discussed below. Consistent with the change to section 403(b)(1) made in JCWAA, these regulations provide that the limitations under section 415(c) apply to any section 403(b) annuity contract, regardless of whether the contract satisfies the requirements of section 414(i) to be a defined contribution plan. Thus, the limitations under section 415(c) apply to a section 403(b) annuity contract even if the limitations of section 415(b) also apply to the contract. Section 415(b) applies to the contract if the contract is a church plan that is covered by the grandfather rule of section 251(e)(5) of TEFRA.

Consistent with Rev. Rul. 2002-45, the regulations provide that a restorative payment that is allocated to a participant's account does not give rise to an annual addition for any limitation year. For this purpose, restorative payments are payments made to restore losses to a plan resulting from actions by a fiduciary for which there is a reasonable risk of liability for breach of a fiduciary duty under Title I of ERISA, where plan participants who are similarly situated are treated similarly with respect to the payments. Commentators suggested that restorative payments should also include payments made to restore losses to a plan resulting from actions by a fiduciary for which there is a reasonable risk of liability for breach of a fiduciary duty under other applicable federal or state law, to take into account contributions under plans that are not subject to Title I of ERISA in appropriate circumstances. These regulations adopt this suggestion. Accordingly, payments to a defined contribution plan are restorative payments only if the payments are made in order to restore some or all of the plan's losses due to an action (or a failure to act) that creates a reasonable risk of liability for such a breach of fiduciary duty under Title I of ERISA or under other applicable federal or state law. The regulations specifically list certain payments that satisfy this rule, including payments to a plan made pursuant to a Department of Labor order or court-approved settlement to restore losses to a qualified defined contribution plan on account of the breach of fiduciary duty, and payments made pursuant to the Department of Labor's Voluntary Fiduciary Correction Program to restore losses to a qualified defined contribution plan on account of the breach of fiduciary duty.

As under the proposed regulations, these final regulations provide that the Commissioner may in appropriate cases, considering all of the facts and circumstances, treat transactions between the plan and the employer, transactions between the plan and the employee, or certain allocations to participants' accounts as giving rise to annual additions. For example, in general, the Commissioner will treat payments made to a plan by an employer or another party to make up for losses due merely to market fluctuations and other payments that are not made on account of a reasonable risk of liability for breach of a fiduciary duty under Title I of ERISA or other Federal or state law generally as contributions that give rise to annual additions. As under the proposed

regulations, these regulations clarify that where an employee or employer transfers assets to a plan in exchange for consideration that is less than the fair market value of the assets transferred to the plan, there is an annual addition in the amount of the difference between the value of the assets transferred and the consideration.

For taxable employers, these regulations retain the rule under the 1981 regulations that an employer contribution is not treated as credited to a participant's account for a particular limitation year unless the contribution is actually made to the plan no later than 30 days after the end of the period described in section 404(a)(6) applicable to the taxable year with or within which the particular limitation year ends. The final regulations modify the corresponding rule for tax-exempt employers in the proposed regulations. Under the final regulations, a contribution to a plan by a tax-exempt employer is taken into account for a limitation year for purposes of section 415(c) if the contribution is credited to a participant's account no later than the 15th day of the tenth calendar month following the end of the calendar year or fiscal year (as applicable, depending on the basis on which the employer keeps its books) with or within which the particular limitation year ends. This date corresponds to the due date for Form 5500, "Annual Return/Report of Employee Benefit Plan," (with extensions) in cases in which the calendar or fiscal year coincides with the plan year and generally corresponds to the date for taxable employers who request filing extensions. The extent to which elective contributions constitute plan assets for purposes of the prohibited transaction provisions of section 4975 and Title I of ERISA is determined in accordance with regulations and rulings issued by the Department of Labor. See 29 CFR 2510.3-102.

The final regulations clarify that if the allocation of an annual addition is dependent under the terms of the plan upon the satisfaction of a condition that has not been satisfied by the date as of which the annual addition is allocated, then the annual addition is considered allocated as of the date the condition is satisfied. This is a change from the proposed regulations, under which this rule only applied if the allocation was dependent upon participation in the plan as of a particular date. Additionally, the final regulations clarify that an annual addition that is made pursuant to a corrective amendment that complies with the requirements of § 1.401(a)(4)-11(g) is

credited to the account of a participant for a particular limitation year if it is allocated to the participant's account under the terms of the corrective amendment as of any date within that limitation year.

These regulations clarify the operation of the special increased limitation applicable to church plans under section 415(c)(7). Under this rule, notwithstanding the generally applicable limitations, annual additions for a section 403(b) annuity contract for a year with respect to an individual who is a church employee are treated as not exceeding the limitation of section 415(c) if such annual additions for the year are not in excess of \$10,000. However, the total amount of additions with respect to any participant that are permitted to be taken into account for purposes of this rule for all years may not exceed \$40,000. The regulations also reflect a special rule for church employees performing services outside the United States, as amended by GOZA. Under this special rule, for any individual who is a church employee performing any services for the church outside the United States during the limitation year, additions for a section 403(b) annuity contract for any year are not treated as exceeding the limitations of section 415(c) if those annual additions for the year do not exceed \$3,000 (but only if the individual's adjusted gross income does not exceed \$17,000). These regulations clarify that the \$40,000 cumulative total only applies to excesses over what would have been permitted to be contributed without regard to this special rule, and clarify the interaction between the generally applicable church employee rule and the rule for church employees performing services outside the United States.

As under the proposed regulations, these regulations do not include the correction methods for excess annual additions applicable under § 1.415-6(b)(6) of the 1981 regulations. Conforming changes have been made to § 1.401(a)-2(b), § 1.401(a)(9)-5, A-9(b)(1), and § 1.402(c)-2, A-4(a) to reflect this deletion.

Despite the deletion, the deleted correction methods are generally permitted under the Employee Plans Compliance Resolution System (EPCRS), Rev. Proc. 2006-27 (2006-22 IRB 945) (see § 601.601(d)(2)). In section 2.02(2) of Rev. Proc. 2006-27, comments were requested on whether the correction methods in former § 1.415-6(b)(6), including the maintenance of suspense accounts, should be retained as options under EPCRS. Pending the issuance of further guidance that takes

into account those comments, plans that are eligible for the Self-Correction Program under section 4 of Rev. Proc. 2006-27 may implement corrections using the methods in former § 1.415-6(b)(6), but only if the requirements of section 9 of Rev. Proc. 2006-27 are satisfied, and those corrections will also be taken into account for purposes of the Voluntary Correction and Audit Closing Agreement Programs under EPCRS.

These regulations generally retain the rules under the 1981 regulations providing that a contribution to reduce accumulated funding deficiencies or a contribution made pursuant to a funding waiver relates to the limitation year of the initial funding obligation. However, these regulations, like the proposed regulations, provide that any interest paid by the employer with respect to such a contribution that is in excess of a reasonable amount is taken into account as an annual addition for the limitation year when the contribution is made (in contrast to the 1981 regulations, which required interest in excess of a reasonable amount to be taken into account as an annual addition for the limitation year for which the contribution was originally required). Rev. Rul. 78-223 (1978-1 CB 125) (see § 601.601(d)(2)) provides a method for determining contributions required to amortize waived contributions under a defined contribution plan. The application of any of the methods described in Rev. Rul. 78-223 will result in reasonable interest payments for purposes of applying the rules of section 415 (provided that, if a fixed interest rate in excess of 5 percent is used to amortize waived contributions, the interest rate must be reasonable). Thus, for example, the actual yield method (under which the adjusted account balance is increased or decreased periodically at the actual rate of investment return experienced by the plan for such period) can be used for this purpose.

#### Definition of Compensation (§ 1.415(c)-2)

Section 1.415(c)-2 of these regulations defines the term "compensation," which is defined in section 415(c)(3) and used for purposes of applying the limitations of section 415 as well as for various other purposes specified under the Internal Revenue Code. These regulations reflect a number of statutory changes to section 415(c)(3) that were made after the issuance of the 1981 regulations. Among these changes are the inclusion in compensation of certain deemed amounts for disabled participants and

nontaxable elective amounts for deferrals under sections 401(k), 403(b), and 457, cafeteria plan elections under section 125, and qualified transportation fringe elections under section 132(f)(4). In addition to these changes, these regulations make some other changes to the 1981 regulations, as discussed in this preamble.

The proposed regulations provided specific guidelines regarding when amounts received following severance from employment are considered compensation for purposes of section 415. The proposed regulations provided that the following are types of post-severance payments that are not excluded from compensation because of timing if they are paid within 2½-months following severance from employment: (1) payments that, absent a severance from employment, would have been paid to the employee while the employee continued in employment with the employer and are regular compensation for services during the employee's regular working hours, compensation for services outside the employee's regular working hours (such as overtime or shift differential), commissions, bonuses, or other similar compensation; and (2) payments for accrued bona fide sick, vacation, or other leave, but only if the employee would have been able to use the leave if employment had continued.

Commentators made a number of suggestions regarding the post-severance compensation rules. Some commentators requested a lengthening of the 2½-month period to as long as a year, or exceptions from the 2½-month rule under certain circumstances (such as teacher pay that is paid on a 12-month basis for each 9-month school year, or residual payments that are made to entertainment industry employees years after the services are performed). Some commentators requested changes to the types of compensation that are permitted or required to be taken into account for ease of plan administration.

The final regulations lengthen the time during which certain post-severance payments are taken into account from the 2½-month period under the proposed regulations. The final regulations provide that in order for payments after severance from employment to be treated as compensation within the meaning of section 415(c)(3), payments made for services provided to a former employer must be made by the later of 2½-months after the severance from employment or the end of the limitation year that includes the date of severance from employment. In addition, a governmental plan (within the meaning

of section 414(d)) is permitted to provide that the calendar year that includes the date of severance from employment is substituted for the limitation year that includes the date of severance from employment for this purpose.

The final regulations also provide that post-severance payments of accrued bona fide sick, vacation, and other leave that are paid within the timeframe described in the preceding paragraph are not included in compensation unless the plan specifically includes such payments. Additionally, the final regulations permit a plan to specify that a post-severance payment from a nonqualified unfunded deferred compensation plan may be included in compensation if the payment is made within the timeframe described in the preceding paragraph, but only if the payment would have been made at the same time if the employee had continued his or her employment and only to the extent that the payment is includible in the employee's gross income.

As under the proposed regulations, the rule under the final regulations generally excluding payments after severance from employment from compensation does not apply to payments to an individual who does not currently perform services for the employer by reason of qualified military service (as that term is used in section 414(u)(1)) to the extent those payments do not exceed the amounts the individual would have received if the individual had continued to perform services for the employer rather than entering qualified military service. The final regulations modify the proposed regulations by adding another exception to the post-severance timing rule for compensation paid to a permanently and totally disabled participant, provided certain conditions are satisfied. As provided under the proposed regulations, the final regulations also contain corresponding amendments to the regulations under sections 401(k) and 457 that provide that amounts received following severance from employment can be deferred only if they are considered compensation under the rules of section 415.

Whether a person has a severance from employment with the employer that maintains a plan is determined for purposes of section 415 in the same manner as under § 1.401(k)-1(d)(2), except that for purposes of determining the employer of an employee, the rules of section 415(h) are taken into account (under which the phrase "more than 50 percent" is substituted for the phrase

"at least 80 percent" each place it appears in section 1563(a)(1) for purposes of applying section 414(b) and (c)). Thus, an employee has a severance when the employee ceases to be an employee of the employer maintaining the plan, and an employee does not have a severance from employment if, in connection with a change of employment, the employee's new employer maintains the plan with respect to the employee. In addition, the determination of whether an employee ceases to be an employee of the employer maintaining the plan is based on all of the relevant facts and circumstances. In the case of a multiemployer plan, a payment after severance from employment from an employer for whom services were provided is considered to be compensation within the meaning of section 415(c)(3) as long as the individual receiving the payment is employed by any employer maintaining the multiemployer plan. Thus, in the case of a multiemployer plan, an employee is treated as having a severance from employment only when the employee is no longer providing services to any employer maintaining the multiemployer plan. This rule is consistent with the treatment of a multiemployer plan as a single plan that is not disaggregated for purposes of applying the limitations of section 415.

As noted above, the final regulations provide that a plan cannot take into account compensation in excess of the section 401(a)(17) limit. In addition, the final regulations provide that elective deferrals can only be made from compensation as defined in section 415(c)(3). However, in applying these two rules, a plan is not required to determine a participant's compensation on the basis of the earliest payments of compensation during a year.

Commentators also requested clarification as to the treatment of nonresident aliens under all of the alternative definitions of compensation that the regulations allow. Commentators had noted that the various alternative definitions of compensation permitted under the 1981 regulations could be interpreted as including compensation paid to nonresident aliens, but the commentators observed that this issue was not sufficiently clear.

These regulations provide that amounts paid to an individual as compensation for services do not fail to be treated as compensation merely because those amounts are not includible in the individual's gross income on account of the location of the services. Similarly, these regulations

also provide that amounts paid to an individual as compensation for services do not fail to be treated as compensation merely because those amounts are paid by an employer with respect to which payments of compensation to the individual are excluded from gross income. Thus, for example, the determination of whether an amount is includible as compensation is made without regard to the exclusions from gross income under sections 872, 893, 894, 911, and 933.

Under these modified rules, an employee who is a nonresident alien with no United States sourced income is not prevented from participating in a qualified plan sponsored by the employee's employer on account of the limitations of section 415 that relate to the employee's compensation. These rules, however, do not modify other requirements with respect to such an employee's participation in a qualified plan, such as the rules relating to the entity that is properly entitled to a deduction for contributions made to the plan on account of the employee's participation.

These regulations also provide a rule of administrative convenience under which section 415 compensation does not include compensation paid to a nonresident alien, provided that the individual does not participate in the plan and the compensation is not effectively connected with the conduct of a trade or business within the United States, and only to the extent that the compensation is excludable from the individual's gross income either on account of the location of the services or because compensation paid by the employer is excludable from gross income. This is relevant for purposes of determining who is a key employee under the top heavy rules of section 416 and who is a highly compensated employee under the rules of section 414(q).

Like the proposed regulations, these final regulations generally retain the rules in the 1981 regulations regarding section 415 compensation and contributions to and distributions from plans of deferred compensation. Accordingly, these regulations provide that distributions from a plan of deferred compensation (whether or not qualified) are not compensation for section 415 purposes (but permit a plan to include as compensation amounts received by an employee pursuant to a nonqualified unfunded plan for the year in which the amounts are actually received) and provide that contributions made by an employer (other than elective contributions) to a plan of deferred compensation (whether or not

qualified) are not compensation to the extent that the contributions are not includible in the income of the employee for the taxable year in which contributed. The final regulations clarify that section 415 compensation includes amounts that are includible in the gross income of an employee under the rules of section 409A or section 457(f)(1)(A) or because the amounts are constructively received by the employee. The final regulations also clarify that a plan is permitted to include as compensation amounts received by an employee pursuant to a nonqualified deferred compensation plan only to the extent such amounts are includible in gross income.

#### Cost-of-Living Adjustments (§ 1.415(d)-1)

Section 1.415(d)-1 of these regulations sets forth rules that apply to cost-of-living adjustments to the various limitations of section 415 pursuant to section 415(d). Section 415(d) provides for the dollar and compensation limitations on annual benefits and the dollar limitation on annual additions to be adjusted annually for increases in the cost of living based on adjustment procedures similar to the procedures used to adjust social security benefit amounts. These adjustments also apply for other purposes as specified in the Code. These regulations specify the manner in which these adjustments are determined each year, and reflect statutory changes to the adjustment methodology made after the 1981 regulations were issued. In addition, these regulations make several other changes to the 1981 regulations, as discussed in this preamble. Section 1.415(d)-1 generally retains the rules set forth in the proposed regulations except as indicated in this preamble.

These regulations specify the circumstances under which an adjusted limit is permitted to be applied to participants who have previously commenced receiving benefits under a defined benefit plan. Under these regulations, the adjusted dollar limitation is applicable to current employees who are participants in a defined benefit plan and is permitted to apply to former employees who have retired or otherwise terminated their service under the plan and have a nonforfeitable right to accrued benefits, regardless of whether they have actually begun to receive benefits. If a participant has commenced receiving benefits, the annual increase is only permitted to be applied to the extent that benefits have not been paid. Thus, for example, a plan cannot provide that this annual increase applies to a

participant who has previously received the entire plan benefit in a single-sum distribution. However, a plan is permitted to provide for an increase in benefits to a participant to the extent the participant accrues additional benefits under the plan that could have been accrued without regard to the adjustment of the dollar limitation (including benefits that accrue as a result of a plan amendment) on or after the effective date of the adjusted limitation.

These regulations retain the safe harbor set forth in the proposed regulations under which the annual benefit will satisfy the limitations of section 415(b) for the current limitation year following an adjustment to benefit payments that is made to reflect the cost-of-living adjustment made pursuant to section 415(d). Under this safe harbor, if a plan incorporates by reference the annual section 415(d) cost-of-living adjustments to the limitations of section 415, a distribution that is increased solely as a result of the application of the section 415(d) cost-of-living adjustments to the applicable limits will be treated as continuing to satisfy the requirements of section 415(b) and is not subject to the multiple annuity starting date rules. In connection with the changes discussed in the following paragraph, this safe harbor has been relocated to § 1.415(a)-1(d)(3)(v).

Commentators expressed concern that the safe harbor in the proposed regulations did not cover situations where benefits are increased periodically by plan amendments that reflect the section 415(d) cost-of-living adjustments. After consideration of these comments, the IRS and the Treasury Department have determined that additional safe harbors are appropriate. Accordingly, under these final regulations, if a plan is amended to apply the adjusted section 415(b) limits in accordance with either of two safe harbors, a distribution that is increased pursuant to the amendment will be treated as continuing to satisfy the requirements of section 415(b).

A plan amendment satisfies the first safe harbor if the employee has received one or more distributions that satisfy the requirements of section 415(b) before the date the adjustment to the applicable limits is effective, the increased distribution is solely as a result of the amendment of the plan to reflect the adjustment to the applicable limits pursuant to section 415(d), and the amounts payable to the employee on and after the effective date of the adjustment are not greater than the amounts that would otherwise be

payable without regard to the adjustment, multiplied by a fraction determined for the limitation year, the numerator of which is the limitation under section 415(b) (which is the lesser of the applicable dollar limitation under section 415(b)(1)(A), as adjusted for age at commencement, and the applicable compensation-based limitation under section 415(b)(1)(B)) in effect for the distribution following the section 415(d) adjustment, and the denominator of which is such limitation under section 415(b) in effect for the distribution immediately before the section 415(d) adjustment.

A plan amendment satisfies the second safe harbor if the employee has received one or more distributions that satisfy the requirements of section 415(b) before the date on which the increased distribution is effective, and the amounts payable to the employee on and after the effective date for the increased distribution are not greater than the amounts that would otherwise be payable without regard to the increase, multiplied by the cumulative adjustment fraction. The cumulative adjustment fraction is equal to the product of all of the annual fractions (described in the first safe harbor) that would have applied after benefits commence if the plan had been amended each year to incorporate the section 415(d) adjustments to the applicable section 415(b) limits in accordance with the first safe harbor. In determining the cumulative adjustment fraction, if for the limitation year for which the adjustment in the section 415(b)(1)(A) dollar limit pursuant to EGTRRA is first effective (generally, the first limitation year beginning after December 31, 2001), the section 415(b)(1)(A) dollar limit applicable to a participant is less than the section 415(b)(1)(B) compensation limit, then the annual fraction for such year is 1.0.

#### Aggregating Plans (§ 1.415(f)-1)

Section 1.415(f)-1 of these regulations sets forth rules for aggregating plans pursuant to section 415(f). Section 1.415(f)-1 generally retains the rules set forth in the proposed regulations except as indicated in this preamble. Under section 415(f) and these regulations, for purposes of applying the limitations of section 415(b) and (c), all defined benefit plans that have ever been maintained by an employer are treated as one defined benefit plan, and all defined contribution plans that have ever been maintained by an employer are treated as one defined contribution plan. The controlled group rules of section 414(b) and (c) (as modified by section 415(h)), the affiliated service

group rules of section 414(m), and the leased employee rules of section 414(n) apply for purposes of determining whether a plan that is maintained by an entity other than the employer is considered maintained by the employer for purposes of applying the aggregation rules of section 415(f). These basic employer aggregation rules were also contained in the 1981 regulations.

One commentator noted that the proposed regulations incorrectly reflected the rules of section 415(h) (which applies a 50 percent standard in lieu of an 80 percent standard for purposes of applying the control rules) by applying those rules in determining whether two or more organizations are a brother-sister group of trades or businesses under common control under the rules in § 1.414(c)-2(c). These final regulations provide that the rules of section 415(h) do not apply for this purpose.

These final regulations make various changes and clarifications to the 1981 regulations relating to aggregating plans. As under the proposed regulations, these final regulations clarify that an employer's plan must be aggregated with all plans maintained by a predecessor employer (see section 414(a)), regardless of whether any such plan is assumed by the employer.

As under the proposed regulations, the final regulations provide that a former employer is a predecessor employer with respect to a participant in a plan maintained by an employer if the employer maintains a plan under which the participant had accrued a benefit while performing services for the former employer, but only if that benefit is provided under the plan maintained by the employer. In addition, as under the proposed regulations, these final regulations provide pursuant to section 414(a)(2) that, with respect to an employer of a participant, a former entity that antedates the employer is a predecessor employer with respect to the participant if, under the facts and circumstances, the employer constitutes a continuation of all or a portion of the trade or business of the former entity. This will occur, for example, where formation of the employer constitutes a mere formal or technical change in the employment relationship and continuity otherwise exists in the substance and administration of the business operations of the former entity and the employer. See *Lear Eye Clinic, Ltd. v. Commissioner*, 106 T.C. 418, 425 (1996).

These final regulations make several other changes to the employer aggregation rules. These changes limit the extent to which a plan maintained by an employer must aggregate benefits

accrued under a plan that was formerly maintained by the employer or that was maintained by an entity that was formerly affiliated with the employer under the employer aggregation rules of § 1.415(a)-1(f)(1) and (2) (which provide that a plan maintained by any member of a controlled group of employers or an affiliated service group is deemed to be maintained by all members of the group). Under these final regulations, a "formerly affiliated plan" of an employer is treated as if it were a plan that terminated immediately prior to the "cessation of affiliation" with sufficient assets to pay benefit liabilities under the plan, and had purchased annuities to provide plan benefits. The final regulations define a formerly affiliated plan of an employer as a plan that, immediately prior to the cessation of affiliation, was actually maintained by one or more of the entities that constitute the employer (as determined under the employer affiliation rules of § 1.415(a)-1(f)(1) and (2)), and that, immediately after the cessation of affiliation, is not actually maintained by any of the entities that constitute the employer (as determined under the employer affiliation rules of § 1.415(a)-1(f)(1) and (2)). The final regulations define a cessation of affiliation as the event that causes an entity to no longer be aggregated with one or more other entities as a single employer under the employer affiliation rules (such as a sale of a subsidiary) or an event that causes a plan to not actually be maintained by any of the entities that constitute the employer (such as a transfer of sponsorship of a plan to an unrelated employer).

A similar rule is provided under these final regulations with respect to a plan (or portion of a plan) maintained by a predecessor employer that is not assumed by the successor employer. As under the proposed regulations, the final regulations provide that all plans ever maintained by an employer or predecessor employer are aggregated. For purposes of applying this aggregation rule, these final regulations limit the extent to which plans that are not maintained by an employer but that are maintained by the employer's predecessor employer are taken into account when aggregating the employer's plans. This limit provides that a plan that is not maintained by the employer and is maintained by the employer's predecessor employer is treated as if the plan terminated (with sufficient assets to pay benefit liabilities under the plan) immediately prior to the event giving rise to the predecessor employer relationship. The effect of

these rules is that, for purposes of aggregating the predecessor employer's plans with plans maintained by the employer, benefits accrued after the transfer of benefits from the predecessor employer's plan to the employer's plan are excluded.

These final regulations also add a rule that prevents the double counting of a participant's benefit when applying the aggregation rules. For example, in aggregating defined benefit plans of a predecessor employer with the defined benefit plans of an employer following a transfer of benefits to the plan maintained by the employer from the plan maintained by the predecessor employer, the transferee plan (maintained by the employer) does not double count a participant's benefit by taking into account both the transferred benefits and the portion of the transferor plan (maintained by the predecessor employer) that is deemed to have terminated on account of the transfer pursuant to § 1.415(b)-1(b)(3)(i)(B). Instead, the transferee plan includes the benefits that are actually provided under the transferee plan when applying the aggregation rule.

The proposed regulations provided rules for applying the requirements of section 415(f)(2) when an employer has more than one defined benefit plan. Pursuant to section 415(f)(2), the proposed regulations provided that the compensation limit of section 415(b)(1)(B) is applied separately with respect to each plan, and in applying the compensation limit to the aggregated plans, the plans calculate a participant's average compensation for the participant's high 3 years of service by taking into account compensation for all years of active participation in the aggregated plans. Because the requirements of section 415(f)(2) have been rendered moot by the amendment to section 415(b)(3) made by section 832 of PPA '06, these rules have not been incorporated into the final regulations.

These regulations provide rules for aggregating participation and service for purposes of the 10-year phase-in of the limitations on defined benefit plans. Under these rules, years of participation in all aggregated plans and years of service for employers maintaining all aggregated plans are counted for purposes of applying the 10-year phase-in rules.

These regulations clarify the aggregation rules that apply to section 403(b) annuity contracts, other plans of the employer, and plans of related employers, in light of changes made in EGTRRA. Generally, a section 403(b) annuity contract is not aggregated with plans that are maintained by the

participant's employer because the section 403(b) annuity contract is deemed maintained by the participant and not the employer for purposes of section 415. However, if a participant on whose behalf a section 403(b) annuity contract is purchased is in control of any employer for a limitation year, the annuity contract for the benefit of the participant is treated as a defined contribution plan maintained by both the controlled employer and the participant for that limitation year and accordingly, the section 403(b) annuity contract is aggregated with all other defined contribution plans maintained by the employer. Accordingly, the employer that contributes to the section 403(b) annuity contract must obtain information from participants regarding employers controlled by those participants and plans maintained by those controlled employers to monitor compliance with applicable limitations to comply with applicable reporting and withholding obligations.

In general, under these regulations, the benefits provided by all plans maintained by all employers maintaining a multiemployer plan (as defined in section 414(f)) are taken into account in applying the limitations of section 415 to the multiemployer plan. However, a multiemployer plan is permitted to provide that, where a participating employer maintains both a plan which is not a multiemployer plan and a multiemployer plan, only the benefits provided by the employer under the multiemployer plan are aggregated with the benefits under the non-multiemployer plan. By contrast, when a multiple employer plan is aggregated with a single employer plan maintained by the same employer, all of the benefits provided by the multiple employer plan must be taken into account in determining whether the aggregated plans satisfy section 415. These regulations also provide that a multiemployer plan is not aggregated with any other multiemployer plan for purposes of determining any section 415 limitation. In addition, a multiemployer plan is not aggregated with any other non-multiemployer plan for purposes of applying the 100 percent of compensation benefit limit to non-multiemployer plans under section 415(b)(1)(B).

#### Disqualification of Plans and Trusts (§ 1.415(g)–1)

Section 1.415(g)–1 of these final regulations sets forth rules regarding disqualification of plans and trusts, including plans and trusts that are aggregated pursuant to § 1.415(f)–1. In large part, § 1.415(g)–1 of these

regulations replicates the rules of § 1.415–9 of the 1981 regulations regarding ordering rules for disqualifying plans and trusts that are aggregated for purposes of compliance with section 415. In addition, the final regulations provide rules for disqualification where an individual medical benefit account (as described in section 415(l)) and a post-retirement medical benefits account for key employees (as described in section 419A(d)) is aggregated with a qualified defined contribution plan for purposes of applying section 415(c). If the total of the annual additions under both plans exceeds those limitations for a particular limitation year, the qualified defined contribution plan (rather than the medical benefit account) is disqualified for the limitation year.

#### Limitation Year (§ 1.415(j)–1)

Section 1.415(j)–1 of the regulations sets forth rules regarding limitation years that are used as the period for demonstrating compliance with section 415. Section 1.415(j)–1 generally retains the rules set forth in the proposed regulations except as indicated in this preamble. In addition to setting forth general rules that generally correspond to rules under the 1981 regulations, these regulations provide specific guidelines with respect to overlapping limitation years for aggregated plans. These rules reflect the guidance provided in Rev. Rul. 79–5 (1979–1 CB 165) (see § 601.601(d)(2)). Where defined contribution plans with different limitations years are aggregated, the rules of section 415(c) must be applied with respect to each limitation year of each such plan. For each such limitation year, the requirements of section 415(c) are applied to annual additions that are made for that time period with respect to the participant under all aggregated plans. Similarly, where defined benefit plans with different limitation years are aggregated, the rules of section 415(b) must be applied with respect to each limitation year of each such plan. Thus, for example, the dollar limitation of section 415(b)(1)(A) applicable to the limitation year for each plan must be applied to annual benefits under all aggregated plans to determine whether the plan satisfies the requirements of section 415(b).

These final regulations add a rule that applies to a terminating defined contribution plan. If a defined contribution plan is terminated effective as of a date other than the last day of the plan's limitation year, the plan is deemed to have been amended to change its limitation year. As a result of

this deemed amendment, the section 415(c)(1)(A) dollar limit must be pro-rated under the short limitation year rules.

#### Sections 415(m) and (n)

Sections 415(m) and (n) have not been addressed in these regulations. Comments received concerning these provisions in response to the notice of proposed rulemaking that preceded these regulations will be considered for guidance at a later date.

#### Section 416 Regulations

These regulations update the definition of compensation used for purposes of applying the top heavy rules of section 416. Pursuant to statutory amendments to the definition of compensation under section 415(c)(3) under SBJPA and CRA (which were generally effective for years beginning after December 31, 1997), these regulations update the alternative definition of compensation permitted under the section 416 regulations (which is based on compensation reported on Form W–2, "Wage and Tax Statement") to include amounts that would be included on Form W–2 but for an election under sections 125, 132(f)(4), 401(k), 403(b), 408(k), 408(p)(2)(A)(i), or 457(b).

#### Section 457 Regulations

These regulations include revisions to the regulations under section 457 that are in addition to the revisions to reflect the treatment of compensation paid after severance from employment (§ 1.457–4(d)). The additional revisions do not include any substantive changes, but merely make clarifications, including revisions in an example illustrating the section 457 catch-up rules (§ 1.457–5(d) *Example 2*) and a change in the rules relating to unforeseeable emergencies to reflect revisions in the definition of a dependent (made under WFTRA, which modified the definition of the term "dependent" under section 152) (§ 1.457–6(c)).

#### Effective Dates

##### *In General*

These regulations generally apply to limitation years beginning on or after July 1, 2007. However, § 1.401(k)–1(e)(8) applies with respect to compensation paid (or that would have been paid but for a cash or deferred election) in plan years beginning on or after July 1, 2007, and the amendment to § 1.457–4(d) applies to taxable years beginning on or after December 31, 2001 (see § 1.457–12). See §§ 1.457–6(c)(2)(i) and 1.457–12 for the applicability of the modifications to §§ 1.457–5, 1.457–6, and 1.457–10. In



the case of a governmental plan (within the meaning of section 414(d)), §§ 1.415(a)–1, 1.415(b)–1, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 apply to limitation years that begin more than 90 days after the close of the first regular legislative session of the legislative body with authority to amend the plan that begins on or after July 1, 2007. However, a governmental plan is permitted to apply the provisions of §§ 1.415(a)–1, 1.415(b)–1, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 to limitation years beginning on or after July 1, 2007.

In response to commentator concerns, and as provided in Notice 2005–87, these regulations reflect revisions to the effective date provisions of the proposed regulations to expand the benefits that are grandfathered from the application of these regulations. Under these regulations, a defined benefit plan is considered to satisfy the limitations of section 415(b) for a participant with respect to benefits accrued or payable under the plan as of the end of the limitation year that is immediately prior to the effective date of these final regulations for the plan pursuant to plan provisions (including plan provisions relating to the plan's limitation year) that were both adopted and in effect before April 5, 2007, but only if such plan provisions meet the requirements of statutory provisions, regulations, and other published guidance in effect immediately before the effective date of these final regulations. For this purpose, plan provisions will not be treated as failing to satisfy the requirements of statutory provisions, regulations, and other published guidance in effect immediately before the effective date of these final regulations merely because the plan has not been amended to reflect changes to section 415(b) made by PFEA and PPA '06. In addition, for this purpose, plan provisions will not be treated as failing to satisfy the requirements of section 415(b)(1)(B) merely because the plan's definition of compensation for a limitation year that is used for purposes of applying the limitations of section 415(b)(1)(B) reflects compensation for a plan year that is in excess of the limitation under section 401(a)(17) that applies to that plan year. Thus, plans that were in compliance with the rules of section 415 as in effect for limitation years prior to the effective date of these regulations for the plan will not be disqualified based on benefits that arise pursuant to plan provisions that were both adopted and in effect before April 5, 2007, and that accrue prior to the effective date of these

regulations for the plan, even if those benefits no longer comply with the requirements of section 415 as set forth under these final regulations. However, such a plan will not be permitted to provide for the accrual of additional benefits for a participant on or after the effective date of these regulations for the plan unless such additional benefits, together with the participant's other accrued benefits, comply with these regulations.

The preamble to the proposed regulations provided that, pending issuance of final regulations, taxpayers may rely on the modifications contained in the proposed regulations in § 1.401(k)–1(e)(8), § 1.415(c)–2(e), and § 1.457–4(d) regarding post-severance compensation payments and other compensation timing rules. Accordingly, taxpayers may apply those proposed amendments for periods prior to the effective date of these final regulations. The final regulations also provide that taxpayers may apply the post-severance compensation payments and other compensation timing rules contained in the final regulations in § 1.415(c)–2(e) for years prior to the effective date of these final regulations. This early application also is used for purposes of determining compensation in §§ 1.401(k)–1(e)(8) and 1.457–4(d).

#### *Plan Amendment Timing*

Generally, a provision of a plan that results in a failure of the plan to satisfy these final regulations is a disqualifying provision described in § 1.401(b)–1(b)(3)(i). Therefore, the remedial amendment period rules of § 1.401(b)–1 apply. For example, in the case of a plan with a calendar plan year and a calendar limitation year that is maintained by an employer with a calendar taxable year (and the plan is not a governmental plan), the plan's remedial amendment period with respect to a disqualifying plan provision as a result of these final regulations ends on the date prescribed by law for the filing of the employer's income tax return (including extensions) for the 2008 taxable year. In addition, special timing rules apply in the case of certain plan amendments made pursuant to changes made to section 415 by PFEA and PPA '06.

Under section 101(c) of PFEA (prior to amendment by PPA '06), a plan amendment to reflect the 5.5 percent interest rate assumption that is generally required to be used for distributions with annuity starting dates in plan years beginning in years 2004 and 2005 under section 101(b)(4) of PFEA (for determining the actuarially equivalent straight life annuity for a form of benefit that is subject to section 417(e)) must be

made on or before the last day of the first plan year beginning on or after January 1, 2006. Section 301(c) of PPA '06 modified section 101(c) of PFEA by extending the due date for the amendment required under section 101(b)(4) of PFEA to on or before the last day of the first plan year beginning on or after January 1, 2008. Thus, pursuant to section 101(c) of PFEA (as amended by PPA '06), in the case of an amendment to a plan with a calendar year plan year to reflect the interest rate assumption specified by section 101(b)(4) of PFEA, the plan is treated as having been operated in accordance with its terms and the amendment does not violate section 411(d)(6), provided that the plan is operated in conformity with the amendment and the amendment is adopted no later than December 31, 2008.

Under section 1107 of PPA '06, a plan amendment that is made pursuant to PPA '06 (or a regulation issued by the Secretary under PPA '06) must be made on or before the last day of the first plan year beginning on or after January 1, 2009 (January 1, 2011, in the case of a governmental plan within the meaning of section 414(d)). Under section 1107 of PPA '06, if the plan is amended by such date and the plan is operated in conformity with the amendment, the plan is treated as having been operated in accordance with its terms and the amendment does not cause the plan to fail to meet the requirements of section 411(d)(6). A plan amendment is treated as an amendment that is made pursuant to a statutory amendment made by PPA '06 (or a regulation issued by the Secretary under PPA '06) if the amendment is: (i) A plan amendment to reflect the changes to the assumptions in section 415(b)(2)(E) that are used for converting certain forms of benefits to an equivalent straight life annuity in a limitation year beginning on or after January 1, 2006 (section 303 of PPA '06); (ii) a plan amendment to reflect the modifications to the purchase of permissive service credit rules of section 415(n) (section 821 of PPA '06); (iii) a plan amendment to incorporate the exemption from the section 415(b)(1)(B) compensation limit for certain benefits provided under a defined benefit plan maintained by an organization described in section 3121(w)(3)(A) (section 867 of PPA '06); and (iv) a plan amendment to reflect the expansion of the definition of qualified participant in section 415(b)(2)(H) to include certain participants in a defined benefit plan maintained by an Indian tribal government (section 906(b) of PPA '06). However, section 1107 of PPA '06

does not apply for other amendments required by these regulations, unless such amendments are pursuant to a provision of PPA '06 that did not amend section 415 (for example, section 906 of PPA '06, relating to the definition of governmental plan in section 414(d)). Accordingly, there is no extension of the remedial amendment period for such amendments, and such amendments are subject to the requirements of section 411(d)(6).

### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the 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 Code, the notice of proposed rulemaking that preceded these 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 Vernon S. Carter and Linda S. F. Marshall, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), and Christopher A. Crouch, formerly of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in the development of these regulations.

### List of Subjects

#### 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

#### 26 CFR Part 11

Income taxes, Reporting and recordkeeping requirements.

### Adoption of Amendments to the Regulations

■ Accordingly, 26 CFR parts 1 and 11 are 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.** For each section set forth in the table, remove the text that appears in the column labeled "Remove" and add the text that appears in the column labeled "Add" in its place.

Regulation cite	Remove	Add
§ 1.401(a)–1(b)(1)(iii) .....	1.415–1(d)(1) .....	1.415(a)–1(d)(1)
§ 1.401(a)(4)–2(c)(2)(ii) .....	1.415–6(b)(2)(i) .....	1.415(c)–1(b)(4)
§ 1.414(s)–1(c)(2) .....	1.415–2(d)(2) and (d)(3) .....	1.415(c)–2(b) and (c)
§ 1.414(s)–1(c)(2) .....	1.415–2(d)(10) and (d)(11) .....	1.415(c)–2(d)(2), (d)(3) and (d)(4)
§ 1.414(s)–1(c)(2) .....	1.415–2(d)(13) .....	1.415(c)–2(d)(1)
§ 1.924(c)–1(d)(6) .....	paragraphs (d)(1) and (2) of § 1.415–2 .....	§ 1.415(c)–2(b) and (c)

■ **Par. 3.** Section 1.401(a)–2(b) is revised to read as follows:

#### § 1.401(a)–2 Impossibility of diversion under qualified plan or trust.

\* \* \* \* \*

(b) *Section 415 suspense account.* Notwithstanding paragraph (a) of this section, a plan, or trust forming part of a plan, may provide for the reversion to the employer, upon termination of the plan, of amounts contributed to the plan that exceed the limitations imposed under section 415(c), to the extent set forth in rules prescribed by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter).

■ **Par. 4.** Section 1.401(a)(9)–5, A–9(b)(1) is revised to read as follows:

#### § 1.401(a)(9)–5 Required minimum distributions from defined contribution plans.

\* \* \* \* \*

A–9. \* \* \*

(b) \* \* \*

(1) Elective deferrals (as defined in section 402(g)(3)) and employee contributions that, pursuant to rules prescribed by the Commissioner in revenue rulings, notices, or other

guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter), are returned to the employee (together with the income allocable thereto) in order to comply with the section 415 limitations.

\* \* \* \* \*

■ **Par. 5.** Section 1.401(k)–1 is amended by adding paragraph (e)(8) to read as follows:

#### § 1.401(k)–1 Certain cash or deferred arrangements.

\* \* \* \* \*

(e) \* \* \*

(8) *Section 415 compensation required.* With respect to compensation that is paid (or would have been paid but for a cash or deferred election) in plan years beginning on or after July 1, 2007, a cash or deferred arrangement satisfies this paragraph (e) only if cash or deferred elections can only be made with respect to amounts that are compensation within the meaning of section 415(c)(3) and § 1.415(c)–2. Thus, for example, the arrangement is not a qualified cash or deferred arrangement if an eligible employee who is not in qualified military service (as that term is defined in section 414(u)) and who is not permanently and totally disabled (as

defined in section 22(e)(3)) can make a cash or deferred election with respect to an amount paid after severance from employment, unless the amount is paid by the later of 2½ months after severance from employment or the end of the year that includes the date of severance from employment and is described in § 1.415(c)–2(e)(3)(ii) or (iii).

\* \* \* \* \*

■ **Par. 6.** Section 1.402(c)–2, A–4(a) is revised to read as follows:

#### § 1.402(c)–2 Eligible rollover distributions; questions and answers.

\* \* \* \* \*

A–4 \* \* \*

(a) Elective deferrals (as defined in section 402(g)(3)) and employee contributions that, pursuant to rules prescribed by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter), are returned to the employee (together with the income allocable thereto) in order to comply with the section 415 limitations.

\* \* \* \* \*

**§§ 1.415-1 through 1.415-10 [Removed]**

■ **Par. 7.** Sections 1.415-1 through 1.415-10 are removed.

■ **Par. 8.** Section 1.415(a)-1 is added to read as follows:

**§ 1.415(a)-1 General rules with respect to limitations on benefits and contributions under qualified plans.**

(a) *Trusts.* Under sections 415 and 401(a)(16), a trust that forms part of a pension, profit-sharing, or stock bonus plan will not be qualified under section 401(a) if any of the following conditions exists:

(1) In the case of a defined benefit plan, the annual benefit with respect to any participant for any limitation year exceeds the limitations of section 415(b) and § 1.415(b)-1.

(2) In the case of a defined contribution plan, the annual additions credited with respect to any participant for any limitation year exceed the limitations of section 415(c) and § 1.415(c)-1.

(3) The trust has been disqualified under section 415(g) and § 1.415(g)-1 for any year.

(b) *Certain annuities and accounts—*

(1) *In general.* Under section 415, an employee annuity plan described in section 403(a), an annuity contract described in section 403(b), or a simplified employee pension described in section 408(k) will not be considered to be described in the otherwise applicable section if any of the following conditions exists:

(i) The annual benefit under a defined benefit plan with respect to any participant for any limitation year exceeds the limitations of section 415(b) and § 1.415(b)-1.

(ii) The contributions and other additions credited under a defined contribution plan with respect to any participant for any limitation year exceed the limitations of section 415(c) and § 1.415(c)-1.

(iii) The employee annuity plan, annuity contract, or simplified employee pension has been disqualified under section 415(g) and § 1.415(g)-1 for any year.

(2) *Special rule for section 403(b) annuity contracts.* If the contributions and other additions under an annuity contract that otherwise satisfies the requirements of section 403(b) exceed the limitations of section 415(c) and § 1.415(c)-1 with respect to any participant for any limitation year (regardless of whether the annuity contract is a defined contribution plan or a defined benefit plan), then the portion of the contract that includes such excess annual addition fails to be a section 403(b) annuity contract, and

the remaining portion of the contract is a section 403(b) annuity contract. However, the status of the remaining portion of the contract as a section 403(b) annuity contract is not retained unless, for the year of the excess and each year thereafter, the issuer of the contract maintains separate accounts for each such portion. In addition, if the benefit under an annuity contract that is a defined benefit plan and that otherwise satisfies the requirements of section 403(b) exceeds the limitations of section 415(b) and § 1.415(b)-1 with respect to any participant for any limitation year, then the contract fails to be a section 403(b) annuity contract.

(3) *Section 403(b) annuity contract.* For purposes of section 415 and regulations promulgated under section 415, the term *section 403(b) annuity contract* includes arrangements that are treated as annuity contracts for purposes of section 403(b). Thus, such term includes custodial accounts described in section 403(b)(7) and retirement income accounts described in section 403(b)(9).

(c) *Regulations—*(1) *In general.* This section provides general rules regarding the application of section 415. For further rules regarding the application of section 415, see—

(i) Section 1.415(b)-1 (for general rules regarding the limits applicable to defined benefit plans);

(ii) Section 1.415(b)-2 (for special rules for defined benefit plans where a participant has multiple annuity starting dates);

(iii) Section 1.415(c)-1 (for general rules regarding the limits applicable to defined contribution plans);

(iv) Section 1.415(c)-2 (for rules regarding the definition of compensation for purposes of section 415);

(v) Section 1.415(d)-1 (for rules regarding cost-of-living adjustments to the various limits of section 415);

(vi) Section 1.415(f)-1 (for rules for aggregating plans for purposes of section 415);

(vii) Section 1.415(g)-1 (for rules regarding disqualification of plans that fail to satisfy the requirements of section 415); and

(viii) Section 1.415(j)-1 (for rules regarding limitation years).

(2) *Cross references to special rules for section 403(b) annuity contracts.* For special rules relating to section 403(b) annuity contracts, see—

(i) Section 1.415(c)-2(g)(1) and (3) (relating to the definition of compensation for section 403(b) annuity contracts);

(ii) Section 1.415(f)-1(f) (relating to rules for section 403(b) annuity

contracts for purposes of aggregating plans);

(iii) Section 1.415(g)-1(b)(3)(iv)(C) (regarding disqualification of a section 403(b) annuity contract aggregated with a qualified defined contribution plan if the aggregated plans exceed the limitations of section 415(c));

(iv) Section 1.415(g)-1(c) (relating to the plan year for section 403(b) annuity contracts); and

(v) Section 1.415(j)-1(e) (relating to the limitation year for section 403(b) annuity contracts).

(3) *Cross references to special rules for governmental plans.* For special rules relating to governmental plans, see—

(i) Paragraph (f)(4) of this section (regarding permissive service credits);

(ii) Paragraph (g)(2) of this section (providing a delayed effective date for governmental plans);

(iii) Section 1.415(b)-1(a)(6)(i) (providing an exception from the compensation-based limit of section 415(b)(1)(B) for governmental plans);

(iv) Section 1.415(b)-1(a)(7)(ii) (regarding a special limitation for certain governmental plans making an election during 1990);

(v) Section 1.415(b)-1(b)(4) (regarding qualified governmental excess benefit arrangements);

(vi) Section 1.415(b)-1(d)(3) and (4) (regarding age adjustments to the dollar limit of section 415(b)(1)(A) for employees of police and fire departments and members of the Armed Forces of the United States, and for survivor and disability benefits);

(vii) Section 1.415(b)-1(g)(3) (regarding adjustments to applicable limitations for years of participation, and adjustments to applicable limitations for years of service for survivor and disability benefits under governmental plans);

(viii) Section 1.415(c)-1(b)(2)(ii) and (3)(iii) (regarding amounts not treated as annual additions under governmental plans); and

(ix) Section 1.415(c)-2(e)(5) (providing an alternative rule for inclusion of compensation after a severance from employment for governmental plans).

(4) *Cross references to special rules for multiemployer plans.* For special rules relating to multiemployer plans as defined in section 414(f), see—

(i) Paragraph (e) of this section (regarding benefits or contributions taken into account where a plan is maintained by more than one employer);

(ii) Paragraph (f)(5)(ii) of this section (providing a special definition of severance from employment for multiemployer plans);

(iii) Section 1.415(b)–1(a)(6)(ii) (providing an exception from the compensation-based limit for multiemployer plans);

(iv) Section 1.415(b)–1(f)(3) (regarding the application of the minimum \$10,000 limitation on benefits in the case of a multiemployer plan);

(v) Section 1.415(f)–1(g) (providing special rules for aggregating multiemployer plans with other plans); and

(vi) Section 1.415(g)–1(b)(3)(ii) (regarding plan disqualification rules where a multiemployer plan is aggregated with a plan that is not a multiemployer plan and the aggregated plans exceed the limitations of section 415).

(5) *Cross references to special rules for plans that are not subject to the requirements of section 411.* For special rules relating to plans that are not subject to the requirements of section 411, see—

(i) Paragraph (d)(1) of this section and § 1.415(b)–1(a)(7)(iii) (providing that the rule limiting accruals to the section 415(b) limits does not apply to plans that are not subject to the requirements of section 411); and

(ii) Section 1.415(b)–1(b)(2)(iii) (providing rules for applying the section 411(c) factors in determining the annual benefit attributable to employee contributions for plans that are not subject to the requirements of section 411).

(6) *Cross references to special rules for plans maintained by churches.* For special rules relating to plans maintained by churches as defined in section 3121(w)(3)(A), see §§ 1.415(b)–1(a)(6)(iv) and 1.415(b)–1(a)(7)(iv) (providing an exception from the compensation-based limit for participants who have never been a highly compensated employee of the church).

(d) *Plan provisions—(1) In general.* Although no specific plan provision is required under section 415 in order for a plan to establish or maintain its qualification, the plan provisions must preclude the possibility that any distribution under a defined benefit plan or annual addition under a defined contribution plan will exceed the limitations of section 415. In addition, a defined benefit plan that is subject to the requirements of section 411 must preclude the possibility that any accrual under the plan will exceed the limitations of section 415. A defined benefit plan may include provisions that automatically freeze or reduce the rate of benefit accrual (or limit the benefit payable in the case of a plan that is not subject to the requirements of section

411), and a defined contribution plan may include provisions that automatically limit the annual addition to a level necessary to prevent the limitations of section 415 from being exceeded with respect to any participant. For rules relating to this type of plan provision and the definitely determinable benefit requirement for pension plans, see § 1.401(a)–1(b)(1)(iii). Because § 1.401(a)–1(b)(1)(iii) requires that the operation of such a provision preclude discretion by the employer, if two defined benefit plans that are aggregated under the rules of section 415(f) would otherwise provide for aggregate benefits that might exceed the limits of section 415(b), the plan provisions must specify (without involving employer discretion) how benefits will be limited to prevent a violation of section 415(b).

(2) *Special rule for profit-sharing and stock bonus plans.* A provision of a profit-sharing or stock bonus plan that automatically freezes or reduces the amount of annual additions to ensure that the limitations of section 415 will not be exceeded must comply with the requirement set forth in § 1.401–1(b)(1)(ii) or (iii) (as applicable) that such plans provide a definite predetermined formula for allocating the contributions made to the plan among the participants. If the operation of a provision that automatically freezes or reduces the amount of annual additions to ensure that the limitations of section 415 are not exceeded does not involve discretionary action on the part of the employer, the definite predetermined allocation formula requirement is not violated by the provision. If the operation of such a provision involves discretionary action on the part of the employer, the definite predetermined allocation formula requirement is violated. For example, if two profit-sharing plans of one employer otherwise provide for aggregate contributions which may exceed the limits of section 415(c), the plan provisions must specify (without involving employer discretion) under which plan contributions and allocations will be reduced to prevent an excess annual addition and how the reduction will occur.

(3) *Incorporation by reference—(i) In general.* A plan is permitted to incorporate by reference the limitations of section 415, and will not fail to meet the definitely determinable benefit requirement or the definite predetermined allocation formula requirement, whichever applies to the plan, merely because it incorporates the limits of section 415 by reference.

(ii) *Section 415 can be applied in more than one manner, but a statutory or regulatory default rule exists.* Where a provision of section 415 is permitted to be applied in more than one manner but is to be applied in a specified manner in the absence of contrary plan provisions (in other words, a default rule exists), if a plan incorporates the limitations of section 415 by reference with respect to that provision of section 415 and does not specifically vary from the default rule, then the default rule applies. With respect to a provision of section 415 for which a default rule exists, if the limitations of section 415 are to be applied in a manner other than using the default rule, the plan must specify the manner in which the limitation is to be applied in addition to generally incorporating the limitations of section 415 by reference. For example, if a plan generally incorporates the limitations of section 415 by reference and does not restrict the accrued benefits to which the amendments to section 415(b)(2)(E) made by the Uruguay Round Agreements Act of 1994, Public Law 103–465 (108 Stat. 4809) (GATT), apply (as permitted by Q&A–12 of Rev. Rul. 98–1 (1998–1 CB 249) (see § 601.601(d)(2) of this chapter), which reflects the amendments to section 767 of GATT made by section 1449 of the Small Business Job Protection Act of 1996, Public Law 104–188 (110 Stat. 1755)), then the amendments to section 415(b)(2)(E) made by GATT apply to all benefits under the plan.

(iii) *Section 415 can be applied in more than one manner with no statutory or regulatory default.* If a limitation of section 415 may be applied in more than one manner, and if there is no governing principle pursuant to which that limitation is applied in the absence of contrary plan provisions, then the plan must specify the manner in which the limitation is to be applied in addition to generally incorporating the limitations of section 415 by reference. For example, if an employer maintains two profit-sharing plans, and if any participant participates in more than one such plan, then both plans must specify (in a consistent manner) under which of the employer's two profit-sharing plans annual additions must be reduced if aggregate annual additions would otherwise exceed the limitations of section 415(c).

(iv) *Former requirements.* A plan is not permitted to incorporate by reference formerly applicable requirements of section 415 that are no longer in force (such as the limits of former section 415(e)).

(v) *Cost-of-living adjustments*—(A) *In general.* A plan is permitted to incorporate by reference the annual adjustments to the limitations of section 415 that are made pursuant to section 415(d). See § 1.415(d)–1 for additional rules relating to cost-of-living adjustments under section 415(d).

(B) *Cost-of-living adjustments not included in accrued benefit until effective.* Notwithstanding that a plan incorporates the increases to the applicable limits under section 415(d) by reference, the accrued benefit of a participant for purposes of section 411 and any amount payable to a participant for purposes of § 1.415(b)–1(a)(1) are not permitted to reflect increases pursuant to the annual increase under section 415(d) of the dollar limitation described in section 415(b)(1)(A) or the compensation limit described in section 415(b)(1)(B) for any period before the annual increase becomes effective. See § 1.415(d)–1(a)(3) for rules relating to when the annual adjustments to the dollar and compensation limitations are effective. A plan amendment does not violate the requirements of section 411(d)(6) merely because it eliminates the incorporation by reference of the increases under section 415(d) with respect to increases that have not yet occurred.

(C) *Application of increase in defined benefit dollar limit to participants who have incurred a severance from employment or commenced receiving benefits.* If a plan incorporates by reference the annual adjustments to the limitations of section 415 pursuant to this paragraph (d)(3)(v), the plan will be treated as applying the section 415(d) cost-of-living adjustments to the maximum extent permitted under the safe harbor described in § 1.415(d)–1(a)(5), except to the extent provided in this paragraph (d)(3)(v)(C). Thus, such a plan is not subject to the requirements of § 1.415(b)–1(b)(1)(iii) (providing special rules for determining the annual benefit of an employee in the case of multiple annuity starting dates) with respect to benefit increases that result solely from an increase in the section 415(b) limits pursuant to section 415(d). If a plan incorporates by reference the annual adjustments to the limitations of section 415 pursuant to this paragraph (d)(3)(v), the annual increase under section 415(d) of the dollar limitation described in section 415(b)(1)(A) does not apply with respect to a participant if the increase is effective after the participant's severance from employment with the employer maintaining the plan (or, if earlier, after the annuity starting date in the case of a participant who has commenced

receiving benefits), unless the plan specifies that this annual increase applies. Similarly, if a plan incorporates by reference the annual adjustments to the limitations of section 415 pursuant to this paragraph (d)(3)(v), the annual increase under section 415(d) of the compensation-based limitation described in section 415(b)(1)(B) does not apply with respect to a participant for increases that are effective after the participant's severance from employment with the employer maintaining the plan (or, if earlier, after the annuity starting date in the case of a participant who has commenced receiving benefits), unless the plan specifies that this annual increase applies.

(D) *Treatment of cost-of-living adjustments for funding and deduction purposes.* In general, the annual increase under section 415(d) of the dollar limitation described in section 415(b)(1)(A) and the compensation limitation described in section 415(b)(1)(B) is treated as a plan amendment, regardless of whether the plan reflects the increase automatically through operation of plan provisions in accordance with this paragraph (d)(3)(v) or the plan is amended to reflect the increase (pursuant to § 1.415(d)–1(a)(5)). However, where a plan reflects the annual increase under section 415(d) of the dollar limitation described in section 415(b)(1)(A) or the compensation limitation described in section 415(b)(1)(B) automatically through operation of plan provisions pursuant to this paragraph (d)(3)(v), the funding method for the plan is permitted to provide for this annual increase to be treated as an experience loss for purposes of applying sections 404, 412, and 431.

(e) *Rules for plans maintained by more than one employer.* Except as provided in § 1.415(f)–1(g)(2)(i) (regarding application of multiemployer plans with plans other than multiemployer plans), for purposes of applying the limitations of section 415 with respect to a participant in a plan maintained by more than one employer, benefits and contributions attributable to such participant from all of the employers maintaining the plan must be taken into account. Furthermore, in applying the limitations of section 415 with respect to a participant in such a plan, the total compensation received by the participant from all of the employers maintaining the plan is taken into account under the plan, unless the plan specifies otherwise.

(f) *Special rules*—(1) *Affiliated employers.* Pursuant to section 414(b) and § 1.414(b)–1, all employees of all

corporations that are members of a controlled group of corporations (within the meaning of section 1563(a), as modified by section 1563(f)(5), and determined without regard to section 1563(a)(4) and (e)(3)(C)) are treated as employed by a single employer for purposes of section 415. Similarly, pursuant to section 414(c) and regulations promulgated under section 414(c), all employees of trades or businesses that are under common control are treated as employed by a single employer. Thus, any defined benefit plan or defined contribution plan maintained by any member of a controlled group of corporations (within the meaning of section 414(b)) or by any trade or business (whether or not incorporated) that is part of a group of trades or businesses that are under common control (within the meaning of section 414(c)) is deemed maintained by all such members or such trades or businesses. Pursuant to section 415(h), for purposes of section 415, sections 414(b) and 414(c) are applied by using the phrase “more than 50 percent” instead of the phrase “at least 80 percent” each place the latter phrase appears in section 1563(a)(1) and in the regulations under section 414(c) (except for purposes of determining whether two or more organizations are a brother-sister group of trades or businesses under common control under the rules in § 1.414(c)–2(c)).

(2) *Affiliated service groups.* Any defined benefit plan or defined contribution plan maintained by any member of an affiliated service group (within the meaning of section 414(m)) is deemed maintained by all members of that affiliated service group.

(3) *Leased employees*—(i) *In general.* Pursuant to section 414(n), except as provided in paragraph (f)(3)(ii) of this section, with respect to any person (referred to as the recipient) for whom a leased employee (within the meaning of section 414(n)(2)) performs services, the leased employee is treated as an employee of the recipient, but contributions or benefits provided by the leasing organization that are attributable to services performed for the recipient are treated as provided under a plan maintained by the recipient.

(ii) *Exception for leased employees covered by safe harbor plans.* Pursuant to section 414(n)(5), the rule of paragraph (f)(3)(i) of this section does not apply to a leased employee with respect to services performed for a recipient if—

(A) The leased employee is covered by a plan that is maintained by the leasing organization and that meets the

requirements of section 414(n)(5)(B); and

(B) Leased employees (determined without regard to this paragraph (f)(3)(ii)) do not constitute more than 20 percent of the recipient's nonhighly compensated workforce.

(4) *Permissive service credit under governmental plans.* See section 415(n) for rules regarding the application of the limitations of sections 415(b) and (c) where a participant makes contributions (including a transfer described in section 403(b)(13) or section 457(e)(17)) to a defined benefit governmental plan to purchase permissive service credit under the plan.

(5) *Definition of severance from employment—(i) General rule.* For purposes of this section and §§ 1.415(b)–1, 1.415(b)–2, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1, whether an employee has a severance from employment with the employer that maintains a plan is determined in the same manner as under § 1.401(k)–1(d)(2) except that, for purposes of determining the employer of an employee, the modifications provided under section 415(h) (described in paragraph (f)(1) of this section) to the employer aggregation rules apply. Thus, an employee has a severance from employment when the employee ceases to be an employee of the employer maintaining the plan, and an employee does not have a severance from employment if, in connection with a change of employment, the employee's new employer maintains such plan with respect to the employee. The determination of whether an employee ceases to be an employee of the employer maintaining the plan is based on all of the relevant facts and circumstances.

(ii) *Multiemployer plans.* A participant in a multiemployer plan (within the meaning of section 414(f)) is not treated as having incurred a severance from employment with the employer maintaining the multiemployer plan for purposes of this section and §§ 1.415(b)–1, 1.415(b)–2, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 if the participant continues to be an employee of another employer maintaining the multiemployer plan.

(6) *Qualified domestic relations orders.* A benefit provided to an alternate payee (as defined in section 414(p)(8)) of a participant pursuant to a qualified domestic relations order (as defined in section 414(p)(1)(A)) is treated as if it were provided to the participant for purposes of applying the limitations of section 415. See § 1.401(a)–13(g)(4)(iv).

(7) *Effect on other requirements.*

Except as provided in § 1.417(e)–1(d)(1), the application of section 415 does not relieve a plan from the obligation to satisfy other applicable qualification requirements. Accordingly, the terms of the plan must provide for the plan to satisfy section 415 as well as all other applicable requirements. For example, if a defined benefit plan has a normal retirement age of 62, and if a participant's benefit remains unchanged between the ages of 62 and 65 because of the application of the section 415(b)(1)(A) dollar limit, the plan satisfies the requirements of section 411 only if the plan either commences distribution of the participant's benefit at normal retirement age (without regard to severance from employment) or provides for a suspension of benefits at normal retirement age that satisfies the requirements of section 411(a)(3)(B) and 29 CFR 2530.203–3. Similarly, if the increase to a participant's benefit under a defined benefit plan in a year after the participant has attained normal retirement age is less than the actuarial increase to the participant's previously accrued benefit because of the application of the section 415(b)(1)(B) compensation limitation (which is not adjusted for commencement after age 65), the plan satisfies the requirements of section 411 only if the plan either commences distribution of the participant's benefit at normal retirement age (without regard to severance from employment) or provides for a suspension of benefits at normal retirement age that satisfies the requirements of section 411(a)(3)(B) and 29 CFR 2530.203–3.

(g) *Effective date—(1) General rule.* Except as otherwise provided, this section and §§ 1.415(b)–1, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 apply to limitation years beginning on or after July 1, 2007.

(2) *Governmental plans.* In the case of a governmental plan as defined in section 414(d), this section and §§ 1.415(b)–1, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 apply to limitation years that begin more than 90 days after the close of the first regular legislative session of the legislative body with authority to amend the plan that begins on or after July 1, 2007. A governmental plan is permitted to apply the provisions of this section and §§ 1.415(b)–1, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 to limitation years beginning on or after July 1, 2007, provided the plan applies all the applicable provisions of this section and §§ 1.415(b)–1, 1.415(c)–1, 1.415(c)–2,

1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 for such limitation years.

(3) *Option to apply regulations earlier.* A plan may apply the rules in § 1.415(c)–2(e) regarding post-severance compensation payments for limitation years prior to the effective date described in paragraphs (g)(1) and (2) of this section. This early application affects the rules relating to the definition of compensation in § 1.401(k)–1(e)(8) and § 1.457–4(d).

(4) *Grandfather rule for preexisting benefits.* A defined benefit plan is considered to satisfy the limitations of section 415(b) for a participant with respect to benefits accrued or payable under the plan as of the end of the limitation year that is immediately prior to the effective date of final regulations under this section and §§ 1.415(b)–1, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 (as provided under paragraph (g)(1) or (2) of this section) pursuant to plan provisions (including plan provisions relating to the plan's limitation year) that were both adopted and in effect before April 5, 2007, but only if such plan provisions meet the applicable requirements of statutory provisions, regulations, and other published guidance relating to section 415 in effect immediately before the effective date of final regulations under this section and §§ 1.415(b)–1, 1.415(c)–1, 1.415(c)–2, 1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1 (as provided under paragraph (g)(1) or (2) of this section). Plan provisions will not be treated as failing to satisfy these requirements merely because the plan has not been amended to reflect changes to section 415(b) made by the Pension Funding Equity Act of 2004, Public Law 108–218 (118 Stat. 596), and the Pension Protection Act of 2006, Public Law 109–280 (120 Stat. 780). In addition, plan provisions will not be treated as failing to satisfy these requirements merely because the plan's definition of compensation for a limitation year that is used for purposes of applying the limitations of section 415(b)(1)(B) reflects compensation for a plan year that is in excess of the limitation under section 401(a)(17) that applies to that plan year. If benefits under a plan are accrued after the applicable effective date under paragraph (g)(1) or (2) of this section, then the sum of the benefits grandfathered under the first sentence of this paragraph (g)(4) and benefits accrued after the applicable effective date must satisfy the requirements of section 415, taking into account the requirements of this section and §§ 1.415(b)–1, 1.415(c)–1, 1.415(c)–2,

1.415(d)–1, 1.415(f)–1, 1.415(g)–1, and 1.415(j)–1.

■ **Par. 9.** Section 1.415(b)–1 is added to read as follows:

**§ 1.415(b)–1 Limitations for defined benefit plans.**

(a) *General rules*—(1) *Maximum limitations.* Except as otherwise provided under this section, a defined benefit plan fails to satisfy the requirements of section 415(a) for a limitation year if, during the limitation year, either the annual benefit (as defined in paragraph (b)(1)(i) of this section) accrued by a participant (whether or not the benefit is vested) or the annual benefit payable to a participant at any time under the plan exceeds the lesser of—

(i) \$160,000 (as adjusted pursuant to section 415(d), § 1.415(d)–1(a), and this section); or

(ii) 100 percent of the participant's average compensation for the period of the participant's high-3 years of service (as adjusted pursuant to section 415(d), § 1.415(d)–1(a), and this section).

(2) *Defined benefit plan.* For purposes of section 415 and regulations promulgated under section 415, a defined benefit plan is any plan, contract, or account to which section 415 applies pursuant to § 1.415(a)–1(a) or (b) (or any portion thereof) that is not a defined contribution plan within the meaning of § 1.415(c)–1(a)(2). In addition, a section 403(b) annuity contract that is not described in section 414(i) is treated as a defined benefit plan for purposes of section 415 and regulations promulgated under section 415.

(3) *Plan provisions.* As required in § 1.415(a)–1(d)(1), in order to satisfy the limitations on benefits under this section, the plan provisions (including the provisions of any annuity) must preclude the possibility that any annual benefit exceeding these limitations will be accrued (except as provided in paragraph (a)(7)(iii) of this section), distributed, or otherwise payable in any optional form of benefit (including the normal form of benefit) at any time (from the plan, from an annuity contract that will make distributions to the participant on behalf of the plan, or from an annuity contract that has been distributed under the plan). Thus, for example, a plan that is subject to the requirements of section 411 will fail to satisfy the limitations of this section if the plan does not contain terms that preclude the possibility that any annual benefit exceeding these limitations will be accrued or payable in any optional form of benefit (including the normal

form of benefit) at any time, even though no participant has actually accrued a benefit in excess of these limitations.

(4) *Adjustments to dollar limitation for commencement before age 62 or after age 65.* The age-adjusted section 415(b)(1)(A) dollar limit computed pursuant to paragraph (d) or (e) of this section is used in place of the dollar limitation described in section 415(b)(1)(A) and paragraph (a)(1)(i) of this section in the case of a benefit with an annuity starting date that occurs before the participant attains age 62 or after the participant attains age 65.

(5) *Average compensation for period of high-3 years of service*—(i) *In general.* Except as otherwise provided in this paragraph (a)(5), for purposes of applying the limitation on benefits described in this section, the period of a participant's high-3 years of service is the period of 3 consecutive calendar years (taking into account the rule in paragraph (a)(5)(iii) of this section) during which the employee had the greatest aggregate compensation (as defined in § 1.415(c)–2) from the employer, and the average compensation for the period of a participant's high-3 years of service is determined by dividing the aggregate compensation for this period by 3. For purposes of this paragraph (a)(5), in determining a participant's high-3 years of service, the plan may use any 12-month period to determine a year of service instead of the calendar year, provided that it is uniformly and consistently applied in a manner that is specified under the terms of the plan. As provided under § 1.415(c)–2(f), because a plan is not permitted to base benefits on compensation in excess of the limitation under section 401(a)(17), a plan's definition of compensation for a year that is used for purposes of applying the limitations of section 415 is not permitted to reflect compensation for a year that is in excess of the limitation under section 401(a)(17) that applies to that year. See §§ 1.401(a)(17)–1(a)(3)(i) and 1.401(a)(17)–1(b)(3)(ii) for rules regarding the effective date of increases in the section 401(a)(17) compensation limitation for a plan year and for a 12-month period other than the plan year.

(ii) *Short periods of service.* For a participant who is employed with an employer for less than 3 consecutive years, the period of the participant's high-3 years of service is the actual number of consecutive years of service (including fractions of years, but not less than one year). In such a case, the limitation of section 415(b)(1)(B) of 100 percent of the participant's average

compensation for the period of the participant's high-3 years of service is computed by dividing the participant's compensation during the participant's longest consecutive period of service by the number of years in that period (including fractions of years, but not less than one year). The rule in paragraph (a)(5)(iii) of this section is used for purposes of determining a participant's consecutive years of service.

(iii) *Break in service.* In the case of a participant who has had a severance from employment with an employer that maintains the plan and who is subsequently rehired by the employer, the period of the participant's high-3 years of service is calculated by excluding all years for which the participant performs no services for and receives no compensation from the employer maintaining the plan (referred to as the break period), and by treating the year of service immediately prior to and the year of service immediately after the break period as if such years of service were consecutive. See § 1.415(d)–1(a)(2)(iii) for a special rule for determining a rehired participant's section 415(b)(1)(B) compensation limit in the case of a plan that adjusts the compensation limit for limitation years after the limitation year in which the participant incurs a severance from employment.

(iv) *Examples.* For purposes of these examples, except as otherwise stated, the plan year and the limitation year are the calendar year, and the plan uses the calendar year for purposes of determining the period of high-3 years of service. In addition, except as otherwise stated, it is assumed that the plan's normal retirement age is 65, and all participants discussed in these examples have at least ten years of service with the employer and at least ten years of participation in the plan at issue. It is also assumed that none of the plans in the examples are governmental plans. The following examples illustrate the rules of this paragraph (a)(5):

*Example 1. (i) Facts.* Plan A, which was established on January 1, 2008, covers Participant M, who was hired on January 1, 1990. Participant M's compensation (as defined in § 1.415(c)–2) from the employer maintaining the plan is \$140,000 each year for 1990 through 1992, is \$120,000 each year for 1993 through 1997, and is \$165,000 for 2008 and 2009. Assume that for Plan A's 2008 and 2009 limitation years, the section 415(b)(1)(A) age-adjusted dollar limit for M is \$185,000 and \$190,000, respectively, prior to the reduction of the age-adjusted dollar limit pursuant to paragraph (g)(1) of this section (which requires a reduction in the dollar limit if a participant has less than 10 years of participation in the plan).



(ii) *Conclusion.* As of the end of the 2008 limitation year, the period of M's high-3 consecutive years of service runs from January 1, 1990, through December 31, 1992, and M's average compensation for this period is \$140,000. Thus, the limitation under section 415(b)(1)(B) for the 2008 limitation year is \$140,000. As of the end of the 2009 limitation year, the period of M's high-3 consecutive years of service runs from January 1, 2007, through December 31, 2009, and M's average compensation for this period is \$150,000. Thus, the limitation under section 415(b)(1)(B) for the 2009 limitation year is \$150,000.

*Example 2 (i) Facts.* Participant N is a participant in Plan B. N's compensation for 2008, 2009, and 2010 is \$300,000 for each year. N's average compensation for the period of N's high-3 years of service (determined before the application of section 401(a)(17)) is \$300,000, based on N's compensation for 2008, 2009, and 2010. For all years before 2008, Participant N's compensation was less than the then-applicable section 401(a)(17) limit. On January 1, 2011, N commences receiving benefits from Plan B at the age of 75, 10 years after attaining N's normal retirement age under Plan B, when the age-adjusted section 415(b)(1)(A) dollar limit for benefits commencing at that age is \$293,453.

(ii) *Conclusion.* Pursuant to § 1.415(c)-2(f) and section 401(a)(17), Plan B is not permitted to provide for a definition of compensation that includes compensation for a year that is in excess of the limitation under section 401(a)(17) that applies to that year. Accordingly, the limitation under section 415(b)(1)(B) based on N's average compensation for the period of N's high three years of service must not reflect compensation for a year that is in excess of the limitation under section 401(a)(17) that applies to that year. Thus, if the limitation under section 401(a)(17) for years beginning in 2008, 2009, and 2010 is \$230,000, \$235,000, and \$240,000, respectively, then the limitation under section 415(b)(1)(B) based on N's average compensation for the period of N's high three years of service is \$235,000.

*Example 3. (i) Facts.* The facts are the same as in *Example 2*, except that N commences receiving benefits from Plan B on January 1, 2008, at the age of 75, 10 years after attaining N's normal retirement age under Plan B. In addition, N's period of high three years of service is from January 1, 2003, through December 31, 2005, and N's average compensation for this period is \$300,000. The section 401(a)(17) limits for 2003, 2004 and 2005 are \$200,000, \$205,000, and \$210,000, respectively. As of December 31, 2007, pursuant to plan provisions adopted and in effect on January 1, 2007, N's accrued benefit under Plan B, payable in the form of a straight life annuity, actuarially adjusted to reflect commencement 10 years after normal retirement age, is \$300,000. Plan B has not been amended during 2007, and that as of December 31, 2007, Plan B satisfied all of the requirements of section 415(b) with respect to N's accrued benefit, pursuant to statutory provisions, regulations, and other published guidance in effect immediately before the limitation year beginning on January 1, 2008.

(ii) *Conclusion.* Under § 1.415(a)-1(g)(4), Plan B is considered to satisfy the section 415(b)(1)(B) compensation limit with respect to N's benefit payable at age 75 of \$300,000 (which N accrued prior to January 1, 2008), for limitation years beginning after December 31, 2007. This is because § 1.415(a)-1(g)(4) provides that plan provisions will not be treated as failing to satisfy the requirements of section 415(b)(1)(B) merely because the plan's definition of compensation that is used for purposes of applying the limitations of section 415(b)(1)(B) reflects compensation in excess of the section 401(a)(17) limitation for limitation years beginning before January 1, 2008. N, however, cannot accrue any additional benefits under Plan B for limitation years beginning after December 31, 2007, until N's section 415(b)(1)(B) compensation limit, as limited by § 1.415(c)-2(f) and section 401(a)(17), increases above \$300,000.

*Example 4. (i) Facts.* Participant O participates in Plan C, maintained by Employer X. Plan C does not adjust a participant's section 415(b)(1)(B) compensation limit for limitation years after the limitation year in which the participant incurs a severance from employment. Prior to separating from employment with X in 2010, O's average compensation for O's period of high-3 years of service is \$50,000, based on O's compensation for 2007, 2008, and 2009, which was \$50,000 for each year. O's compensation for 2010 was \$45,000. O's compensation is \$0 for 2011. In 2012, O is rehired by X and resumes participation in Plan C. O's compensation in 2012 is \$45,000, and is \$70,000 in 2013.

(ii) *Conclusion.* As of the end of the 2013 limitation year, O's average compensation for O's period of high-3 years of service is \$53,333, based on O's compensation in 2010, 2012, and 2013. See paragraph (a)(5)(iii) of this section.

*Example 5. (i) Facts.* The facts are the same as in *Example 4*, except that, in accordance with § 1.415(a)-1(d)(3)(v), Plan C incorporates by reference section 415(d) adjustments to a participant's section 415(b)(1)(B) compensation limit for limitation years after the limitation year in which the participant incurs a severance from employment. Assume that the annual adjustment factor described in § 1.415(d)-1(a)(2)(ii) for 2011 through 2013 is 1.03 for each year. Thus, disregarding O's rehire by X, O's average compensation for O's period of high-3 years of service for the 2013 limitation year is equal to \$54,636 (\$50,000 \* 1.03 \* 1.03 \* 1.03).

(ii) *Conclusion.* Under § 1.415(d)-1(a)(2)(iii), O's average compensation for O's period of high-3 years of service for the 2013 limitation year is \$54,636.

(6) *Exceptions from compensation limit.* The limit under paragraph (a)(1)(ii) of this section (100 percent of the participant's average compensation for the participant's high-3 years of service) does not apply to—

(i) A governmental plan (as defined in section 414(d));

(ii) A multiemployer plan (as defined in section 414(f));

(iii) A collectively bargained plan that is described in section 415(b)(7); or

(iv) A participant in a plan maintained by an organization described in section 3121(w)(3)(A) who has never been a highly compensated employee (within the meaning of section 414(q)) of the organization.

(7) *Special rules—(i) Total benefits not in excess of \$10,000.* See section 415(b)(4) and paragraph (f) of this section for an exception from the limits of section 415(b)(1) and paragraph (a)(1) of this section with respect to retirement benefits that do not exceed \$10,000 for the limitation year.

(ii) *Governmental plans electing during 1990.* For a special limitation applicable to certain governmental plans electing the application of this rule during the first plan year beginning after December 31, 1989, see section 415(b)(10).

(iii) *Defined benefit plans not subject to the requirements of section 411.* In the case of a defined benefit plan that is not subject to the requirements of section 411, the limitations described in this paragraph (a) are not required to be applied to the annual benefit accrued by a participant before the benefit is payable. However, such a defined benefit plan is subject to the limitations described in this paragraph (a) with respect to the annual benefit payable to a participant at any time under the plan.

(iv) *Application of compensation limitation exception to a church employee who becomes a highly compensated employee—(A) In general.* If a participant who was described in paragraph (a)(6)(iv) of this section for a prior limitation year later becomes a highly compensated employee (within the meaning of section 414(q)) of the organization that maintains the defined benefit plan, the plan is not treated as failing to satisfy the compensation-based limitation described in paragraph (a)(1)(ii) of this section with respect to the participant if the requirements of paragraph (a)(7)(iv)(B) of this section are satisfied with respect to the participant.

(B) *Limitation on accruals.* The requirements of this paragraph (a)(7)(iv)(B) are satisfied with respect to a participant if no plan amendments increasing the participant's benefits are adopted during the limitation year in which the participant first becomes a highly compensated employee (within the meaning of section 414(q)) of the organization that maintains the plan, and there is no increase in the participant's accrued benefit derived from employer contributions (including increases as a result of increased compensation or service) in subsequent limitation years.

(b) *Annual benefit*—(1) *In general*—(i) *Definition of annual benefit*—(A) *Straight life annuities.* For purposes of this section and § 1.415(b)–2, the term *annual benefit* means a benefit that is payable in the form of a straight life annuity. A *straight life annuity* means an annuity payable in equal installments for the life of the participant that terminates upon the participant's death. Examples of benefits that are not in the form of a straight life annuity include an annuity with a post-retirement death benefit and an annuity providing a guaranteed number of payments. If a benefit is payable in the form of a straight life annuity, no adjustment is made to the benefit to account for differences in the timing of payments during a year (for example, no adjustment is made on account of the annuity being payable in annual or monthly installments).

(B) *Other benefit forms.* With respect to a benefit payable in a form other than a straight life annuity, the annual benefit is determined as the straight life annuity payable on the first day of each month that is actuarially equivalent to the benefit payable in such other form, determined under the rules of paragraph (c) of this section.

(ii) *Rules for determination of annual benefit.* The annual benefit does not include the annual benefit attributable to either employee contributions or rollover contributions (as described in sections 401(a)(31), 402(c)(1), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16)), determined pursuant to the rules of paragraph (b)(2) of this section. The treatment of transferred benefits is determined under the rules of paragraph (b)(3) of this section. Paragraph (b)(4) of this section discusses the treatment of qualified governmental excess benefit arrangements.

(iii) *Determination of annual benefit in the case of multiple annuity starting dates*—(A) *General rule.* If a participant has or will have distributions commencing at more than one annuity starting date, then the limitations of section 415 must be satisfied as of each of the annuity starting dates, taking into account the benefits that have been or will be provided at all of the annuity starting dates. This will happen, for example, where benefit distributions to a participant have previously commenced under a plan that is aggregated for purposes of section 415 with a plan under which the participant receives current accruals. In determining the annual benefit for such a participant as of a particular annuity starting date, the plan must actuarially adjust the past and future distributions with respect to the benefits that

commenced at the other annuity starting dates. For limitation years to which § 1.415(b)–2 applies, these adjustments must be made using the rules of § 1.415(b)–2. For purposes of this paragraph (b)(1)(iii) and § 1.415(b)–2, the determination of whether a new annuity starting date has occurred is made without regard to the rule of § 1.401(a)–20, Q&A–10(d) (under which the commencement of certain distributions may not give rise to a new annuity starting date).

(B) *Scope of multiple annuity starting date rules.* The rules provided in this paragraph (b)(1)(iii) and § 1.415(b)–2 apply for purposes of determining the annual benefit of a participant where a new distribution election is effective during the current limitation year with respect to a distribution that previously commenced. The rules of this paragraph (b)(1)(iii) and § 1.415(b)–2 also apply for determining the annual benefit of a participant for purposes of applying the limitations of section 415(b) and this section where benefit payments are increased as a result of plan terms or a plan amendment applying a cost-of-living adjustment or similar benefit increase, unless the increase is described in paragraph (b)(1)(iii)(C) of this section.

(C) *Safe harbors for certain benefit increases.* An increase to benefit payments as a result of plan terms or a plan amendment applying a cost-of-living adjustment or similar benefit increase is described in this paragraph (b)(1)(iii)(C) if the increase—

(1) Has previously been accounted for as part of the annual benefit under the rules of paragraph (c) of this section;

(2) Is not required to be accounted for as part of the annual benefit, pursuant to the exception for certain automatic benefit increase features under paragraph (c)(5) of this section;

(3) Is pursuant to a plan provision that automatically incorporates section 415(d) cost-of-living adjustments under § 1.415(a)–1(d)(3)(v); or

(4) Complies with one of the safe harbors described in § 1.415(d)–1(a)(5) or (6) (providing safe harbors for annual and other periodic adjustments to distributions).

(2) *Determination of annual benefit attributable to employee contributions and rollover contributions*—(i) *In general.* If employee contributions (other than contributions described in paragraph (b)(2)(ii) of this section) or rollover contributions are made to the plan, the annual benefit attributable to these contributions is determined as provided in this paragraph (b)(2).

(ii) *Certain employee contributions disregarded.* For purposes of this

paragraph (b)(2), the following are not treated as employee contributions:

(A) Contributions that are picked up by a governmental employer as provided under section 414(h)(2).

(B) Repayment of any loan made to a participant from the plan.

(C) Repayment of a previously distributed amount as described in section 411(a)(7)(B) in accordance with section 411(a)(7)(C).

(D) Repayment of a withdrawal of employee contributions as provided under section 411(a)(3)(D).

(E) Repayments that would have been described in paragraph (b)(2)(ii)(C) or (b)(2)(ii)(D) of this section except that the plan does not restrict the timing of repayments to the maximum extent permitted by section 411(a).

(iii) *Annual benefit attributable to mandatory employee contributions.* In the case of mandatory employee contributions as defined in section 411(c)(2)(C) and § 1.411(c)–1(c)(4) (or contributions that would be mandatory employee contributions if section 411 applied to the plan), the annual benefit attributable to those contributions is determined by applying the factors applicable to mandatory employee contributions as described in section 411(c)(2)(B) and (C) and regulations promulgated under section 411 to those contributions to determine the amount of a straight life annuity commencing at the annuity starting date, regardless of whether the requirements of sections 411 and 417 apply to that plan. For purposes of applying such factors to a plan that is not subject to the requirements of section 411, the applicable effective date of section 411(a)(2) (which is used under § 1.411(c)–1(c)(3) to determine the beginning date from which statutorily specified interest must be credited to mandatory employee contributions) must be determined as if section 411 applied to the plan, and in determining the annual benefit that is actuarially equivalent to these accumulated contributions, the plan must determine the interest rate that would have been required under section 417(e)(3) as if section 417 applied to the plan. See § 1.415(c)–1(a)(2)(ii)(B) and (b)(3) for rules regarding treatment of mandatory employee contributions to a defined benefit plan as annual additions under a defined contribution plan.

(iv) *Voluntary employee contributions.* If voluntary employee contributions are made to the plan, the portion of the plan to which voluntary employee contributions are made is treated as a defined contribution plan pursuant to section 414(k) and, accordingly, is a defined contribution

plan pursuant to § 1.415(c)–1(a)(2)(i). Accordingly, the portion of a plan to which voluntary employee contributions are made is not a defined benefit plan within the meaning of paragraph (a)(2) of this section and is not taken into account in determining the annual benefit under the portion of the plan that is a defined benefit plan.

(v) *Annual benefit attributable to rollover contributions.* The annual benefit attributable to rollover contributions from an eligible retirement plan, as defined in section 402(c)(8)(B) (for example, a contribution received pursuant to a direct rollover under section 401(a)(31)(A)), is determined in the same manner as the annual benefit attributable to mandatory employee contributions if the plan provides for a benefit derived from the rollover contribution (other than a benefit derived from a separate account to be maintained with respect to the rollover contribution and actual earnings and losses thereon). Thus, in the case of rollover contributions from a defined contribution plan to a defined benefit plan to provide an annuity distribution, the annual benefit attributable to those rollover contributions for purposes of section 415(b) is determined by applying the rules of section 411(c) as described in paragraph (b)(2)(iii) of this section, regardless of the assumptions used to compute the annuity distribution under the plan and regardless of whether the plan is subject to the requirements of sections 411 and 417. Accordingly, in such a case, if the plan uses more favorable factors than those specified in section 411(c) to determine the amount of annuity payments arising from rollover contributions, the annual benefit under the plan would reflect the excess of those annuity payments over the amounts that would be payable using the factors specified in section 411(c). See § 1.415(c)–1(b)(3)(i) for rules excluding rollover contributions maintained in a separate account that is treated as a defined contribution plan pursuant to section 414(k) from annual additions to a defined contribution plan.

(3) *Treatment of transferred benefits—*(i) *In general—*(A) *Treatment of transferor plan if transferred benefits are aggregated with transferor plan.* Except as provided in paragraph (b)(3)(ii) of this section, when there has been a transfer of benefits from one defined benefit plan to another plan, to the extent the benefits transferred to the transferee plan are otherwise required to be taken into account pursuant to section 415(f) and § 1.415(f)–1 in determining whether the transferor plan satisfies the limitations of section 415(b)

for a limitation year, the transferred benefits are not treated as being provided under the transferor plan. This will occur, for example, if the employer sponsoring the transferor plan and the employer sponsoring the transferee plan are in the same controlled group within the meaning of section 414(b).

(B) *Treatment of transferor plan if transferred benefits are not aggregated with transferor plan.* Except as provided in paragraph (b)(3)(ii) of this section, when there has been a transfer of benefits from one defined benefit plan to another plan, to the extent the benefits transferred to the transferee plan are not otherwise required to be taken into account pursuant to section 415(f) and § 1.415(f)–1 in determining whether the transferor plan satisfies the limitations of section 415(b) for a limitation year, the transferred benefits are treated by the transferor plan as if such benefits were provided under annuities purchased to provide benefits under a plan that must be aggregated with the transferor plan and that terminated immediately prior to the transfer with sufficient assets to pay all benefit liabilities under the plan, in accordance with the rules of paragraph (b)(5)(i) of this section. This will occur, for example, in the case of a transfer of benefits between defined benefit plans maintained by employers that are not required to be aggregated under sections 414(b) and (c) (as modified by section 415(h)) or sections 414(m).

(C) *Treatment of transferee plan.* Except as provided in paragraph (b)(3)(ii) of this section, where there has been a transfer of benefits from one defined benefit plan to another defined benefit plan, the transferee plan must take into account the transferred benefits in determining whether it satisfies the limitations of section 415(b).

(ii) *Elective transfer of distributable benefit.* Where, as described in § 1.411(d)–4, Q&A–3(c) (permitting certain elective transfers of distributable benefits), a distributable benefit is transferred to a defined benefit plan from either a defined contribution plan or a defined benefit plan, the amount transferred is treated as a benefit paid from the transferor plan, and the annual benefit provided by the transferee defined benefit plan does not include the annual benefit attributable to the amount transferred (determined as if the transferred amount were a rollover contribution subject to the rules of paragraph (b)(2)(v) of this section). The rule in the preceding sentence applies regardless of whether the requirements of section 411 apply to the plan and, in the case of a transfer from a defined

contribution plan that is not subject to the requirements of section 411 (such as a governmental plan) to a defined benefit plan, the rule applies even if the participant's benefits are not distributable from the defined contribution plan at the time of the transfer.

(4) *Treatment of qualified governmental excess benefit arrangements.* Pursuant to section 415(m), in determining whether a governmental plan (as defined in section 414(d)) meets the requirements of this section, the annual benefit does not include benefits provided under a qualified governmental excess benefit arrangement, as defined in section 415(m)(3). Thus, the limitation of section 415(b) does not apply to benefits to the extent the benefits are provided under a qualified governmental excess benefit arrangement.

(5) *Treatment of benefits provided under a terminated plan—*(i) *Terminated plan with sufficient assets.* If a defined benefit plan is terminated with sufficient assets for the payment of the benefit liabilities of all plan participants and a participant in the plan has not yet commenced benefits under the plan, for purposes of satisfying section 415(b) with respect to the participant, all other defined benefit plans maintained by the employer that maintained the terminated plan are required to take into account the benefits provided pursuant to the annuities purchased to provide benefits under the terminated plan at each possible annuity starting date. In such a case, see paragraph (b)(1)(iii) of this section for rules regarding the determination of a participant's annual benefit if the participant commences receiving benefits under the terminated plan.

(ii) *Terminated plan with insufficient assets.* If a defined benefit plan is terminated and there are not sufficient assets for the payment of the benefit liabilities of all plan participants, for purposes of satisfying section 415(b) with respect to a participant, all other defined benefit plans maintained by the employer that maintained the terminated plan are required to take into account the benefits that are actually provided to the participant under the terminated plan. For example, in the case of a plan that is subject to Title IV of the Employee Retirement Income Security Act of 1974 (88 Stat. 829), Public Law 93–406 (ERISA), and that terminates with insufficient assets for the payment of the benefit liabilities of all plan participants, all other defined benefit plans maintained by the employer that maintained the

terminating plan must take into account benefits that are paid by the Pension Benefit Guaranty Corporation. In such a case, see paragraph (b)(1)(iii) of this section for rules regarding the determination of a participant's annual benefit if the participant commences receiving benefits under the terminated plan.

(iii) *Other guidance.* The Commissioner may provide guidance regarding the rules applicable to terminated plans (and plans that are deemed to have been terminated pursuant to paragraph (b)(3)(i)(B) of this section) in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin. See § 601.601(d) of this chapter.

(c) *Adjustment to form of benefit for forms other than a straight life annuity—(1) In general.* This paragraph (c) provides rules for adjusting a form of benefit other than a straight life annuity to an actuarially equivalent straight life annuity beginning at the same time for purposes of determining the annual benefit described in paragraph (b) of this section. Paragraph (c)(2) of this section describes how to adjust a benefit paid in a form to which section 417(e)(3) does not apply. Paragraph (c)(3) of this section describes how to adjust a benefit paid in a form to which section 417(e)(3) applies. Paragraph (c)(4) of this section describes benefit forms for which no adjustment is required. Paragraph (c)(5) of this section provides an exception from the requirements of this paragraph (c) with respect to certain automatic benefit increase features. Paragraph (c)(6) of this section sets forth examples illustrating the application of this paragraph (c). The Commissioner may, in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin set forth simplified methods for adjusting a form of benefit other than a straight life annuity to an actuarially equivalent straight life annuity beginning at the same time for purposes of determining the annual benefit described in paragraph (b) of this section. See § 601.601(d)(2) of this chapter.

(2) *Benefits paid in a form to which section 417(e)(3) does not apply.* For a benefit paid in a form to which section 417(e)(3) does not apply, the actuarially equivalent straight life annuity benefit is the greater of—

(i) The annual amount of the straight life annuity (if any) payable to the participant under the plan commencing at the same annuity starting date as the form of benefit payable to the participant; or

(ii) The annual amount of the straight life annuity commencing at the same

annuity starting date that has the same actuarial present value as the form of benefit payable to the participant, computed using a 5 percent interest assumption and the applicable mortality table described in § 1.417(e)–1(d)(2) for that annuity starting date.

(3) *Benefits paid in a form to which section 417(e)(3) applies—(i) In general.* Except as otherwise provided in this paragraph (c)(3), for a benefit paid in a form to which section 417(e)(3) applies, the actuarially equivalent straight life annuity benefit is the greatest of—

(A) The annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using the interest rate and mortality table, or tabular factor, specified in the plan for actuarial equivalence;

(B) The annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using a 5.5 percent interest assumption and the applicable mortality table for the distribution under § 1.417(e)–1(d)(2); or

(C) The annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable (computed using the applicable interest rate for the distribution under § 1.417(e)–1(d)(3) and the applicable mortality table for the distribution under § 1.417(e)–1(d)(2)), divided by 1.05.

(ii) *Special rule for distributions in plan years beginning in 2004 and 2005.* For a distribution to which section 417(e)(3) applies and which has an annuity starting date occurring in plan years beginning in 2004 or 2005, except as provided in section 101(d)(3) of the Pension Funding Equity Act of 2004, Public Law 108–218 (118 Stat. 596), the actuarially equivalent straight life annuity benefit is the greater of—

(A) The annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using the interest rate and mortality table, or tabular factor, specified in the plan for actuarial equivalence; or

(B) The annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using a 5.5 percent interest assumption and the applicable mortality table for the distribution under § 1.417(e)–1(d)(2).

(4) *Certain benefit forms for which no adjustment is required—(i) In general.*

For purposes of the adjustments described in this paragraph (c), the following benefits are not taken into account:

(A) Survivor benefits payable to a surviving spouse under a qualified joint and survivor annuity (as defined in section 417(b)) to the extent that such benefits would not be payable if the participant's benefit were not paid in the form of a qualified joint and survivor annuity.

(B) Ancillary benefits that are not directly related to retirement benefits, such as preretirement disability benefits not in excess of the qualified disability benefit, preretirement incidental death benefits (including a qualified preretirement survivor annuity), and post-retirement medical benefits.

(ii) *Rules of application—(A) Social security supplements.* Although a social security supplement described in section 411(a)(9) and § 1.411(a)–7(c)(4) may be an ancillary benefit, it is included in determining the annual benefit because it is payable upon retirement and therefore is directly related to retirement income benefits.

(B) *Qualified joint and survivor annuities combined with other distributions.* If benefits are paid partly in the form of a qualified joint and survivor annuity (QJSA) and partly in some other form (such as a single-sum distribution), the rule of paragraph (c)(4)(i)(A) of this section (under which survivor benefits are not included in determining the annual benefit) applies to the survivor annuity payments under the portion of the benefit that is paid in the form of a QJSA.

(5) *Exception for certain automatic benefit increase features—(i) General rule.* Notwithstanding paragraph (b)(1)(i)(B) of this section, no adjustment is required to a benefit that is paid in a form that is not a straight life annuity to take into account the inclusion in that form of an automatic benefit increase feature, as described in paragraph (c)(5)(ii) of this section, if:

(A) The benefit is paid in form to which section 417(e)(3) does not apply.

(B) The plan satisfies the requirements of paragraph (c)(5)(iii) of this section.

(ii) *Definition of automatic benefit increase feature.* An automatic benefit increase feature is included in a form of benefit if that form provides for automatic, periodic increases to the benefits paid in that form, such as a form of benefit that automatically increases the benefit paid under that form annually according to a specified percentage or objective index, or a form of benefit that automatically increases the benefit paid in that form to share

favorable investment returns on plan assets.

(iii) *Requirements.* A plan satisfies the requirements of this paragraph (c)(5)(iii) with respect to a form of benefit that includes an automatic benefit increase feature if the form of benefit without regard to the automatic benefit increase feature satisfies the requirements of section 415(b) and this section, and the plan provides that in no event will the amount payable to the participant under the form of benefit in any limitation year be greater than the section 415(b) limit applicable at the annuity starting date (which is the lesser of the age-adjusted section 415(b)(1)(A) dollar limit described in paragraph (a)(1)(i) of this section or the section 415(b)(1)(B) compensation limit described in paragraph (a)(1)(ii) of this section), as increased in subsequent years pursuant to section 415(d) and § 1.415(d)-1. If the form of benefit without regard to the automatic benefit increase feature is not a straight life annuity, then the preceding sentence is applied by reducing the section 415(b) limit applicable at the annuity starting date to an actuarially equivalent amount (determined using the assumptions specified in paragraph (c)(2)(ii) of this section) that takes into account the death benefits under the form of benefit (other than the survivor portion of a QJSA).

(6) *Examples.* The following examples illustrate the provisions of this paragraph (c). For purposes of these examples, except as otherwise stated, actuarial equivalence under the plan is determined using a 5 percent interest assumption and the mortality table that applies under section 417(e)(3) as of January 1, 2003. It is assumed for purposes of these examples that the interest rate that applies under section 417(e)(3) and § 1.417(e)-1(d)(3) for relevant time periods is 5.25 percent and that the mortality table that applies under section 417(e)(3) and § 1.417(e)-1(d)(2) for relevant time periods is the mortality table that applies under section 417(e)(3) as of January 1, 2003. In addition, it is assumed that all participants discussed in these examples have at least ten years of service with the employer and at least ten years of participation in the plan at issue, all payments other than a payment of a single sum are made monthly, on the first day of each calendar month, and each plan's normal retirement age is 65. The examples are as follows:

*Example 1. (i) Facts.* Plan A provides a single-sum distribution determined as the actuarial present value of the straight life annuity payable at the actual retirement date.

Plan A provides that a participant's single sum is determined as the greater of the present value determined using the otherwise applicable actuarial assumptions of the plan and the present value determined using the applicable interest rate and the applicable mortality table for the distribution under section 417(e)(3). In accordance with § 1.417(e)-1(d)(1), Plan A also provides that the single sum is not less than the actuarial present value of the accrued benefit payable at normal retirement age, determined using the applicable interest rate and the applicable mortality table under section 417(e)(3) and § 1.417(e)-1(d). Participant M retires at age 65 with a benefit under the plan formula (and before the application of section 415) of \$152,619 and elects to receive a distribution in the form of a single sum. Under the plan and before the application of section 415, the amount of the single sum is \$1,800,002 (which is based on the 5 percent interest rate and applicable mortality table as of January 1, 2003, since that present value is greater than the present value that would have been determined using the applicable interest rate (5.25 percent) and the applicable mortality table (the January 1, 2003, table) for the distribution under section 417(e)(3)).

(ii) *Conclusion.* For purposes of this section, the annual benefit is the greatest of the annual amount of the actuarially equivalent straight life annuity commencing at the same age (determined using the plan's actuarial factors), the annual amount of the actuarially equivalent straight life annuity commencing at the same age (determined using a 5.5 percent interest assumption and the applicable mortality table for the distribution under § 1.417(e)-1(d)(2)), and the annual amount of the actuarially equivalent straight life annuity commencing at the same age (determined using the applicable interest rate and applicable mortality table for the distribution under §§ 1.417(e)-1(d)(2) and (d)(3)) divided by 1.05. Based on the factors used in the plan to determine the actuarially equivalent lump sum (in this case, an interest rate of 5 percent and the applicable mortality table as of January 1, 2003), \$1,800,002 payable as a single sum is actuarially equivalent to an immediate straight life annuity at age 65 of \$152,619. A single sum payment of \$1,800,002 is actuarially equivalent to an immediate straight life annuity at age 65 of \$159,105, using a 5.5 percent interest assumption and the applicable mortality table under § 1.417(e)-1(d)(2). Based on the applicable interest rate and the applicable mortality table for the distribution under §§ 1.417(e)-1(d)(2) and (d)(3), \$1,800,002 payable as a single sum is actuarially equivalent to an immediate straight life annuity at age 65 of \$155,853. \$148,432 is the result when this annual amount is divided by 1.05. With respect to the single-sum distribution, M's annual benefit for purposes of section 415(b) is equal to the greatest of the three resulting amounts (\$152,619, \$159,105, and \$148,432), or \$159,105.

*Example 2. (i) Facts.* The facts are the same as in *Example 1*, except that Participant M elects to receive his benefit in the form of a 10-year certain and life annuity. Applying the plan's actuarial equivalence factors, the benefit payable in this form is \$146,100.

(ii) *Conclusion.* Since the form of benefit elected by M is a form of benefit to which section 417(e)(3) does not apply, the annual benefit for purposes of this section is the greater of the annual amount of the plan's straight life annuity commencing at the same age or the annual amount of the actuarially equivalent straight life annuity commencing at the same age, determined using a 5 percent interest rate and the applicable mortality table described in § 1.417(e)-1(d)(2) for that annuity starting date. In this case, the straight life annuity payable under the plan commencing at the same age is \$152,619. Because the plan's factors for actuarial equivalence in this case are the same standardized actuarial factors required to be applied to determine the actuarially equivalent straight life annuity, the actuarially equivalent straight life annuity using the required standardized factors is also \$152,619. With respect to the 10-year certain and life annuity distribution, M's annual benefit is equal to the greater of the two resulting amounts (\$152,619 and \$152,619), or \$152,619.

*Example 3. (i) Facts.* The facts are the same as in *Example 1*. Participant M retires at age 62 with a benefit under the plan (before the application of section 415) of \$100,000 (after application of the plan's early retirement factors) and a Social Security supplement of \$10,000 per year payable until age 65. N chooses to receive the accrued benefit in the form of a straight life annuity. The Plan has no provisions under which the actuarial value of the Social Security supplement can be paid as a level annuity for life.

(ii) *Conclusion.* Because the form of benefit elected by M is a form of benefit to which section 417(e)(3) does not apply and because the plan does not provide for a straight life annuity beginning at age 62, the annual benefit for purposes of this section is the annual amount of the straight life annuity commencing at age 62 that is actuarially equivalent to the distribution stream of \$110,000 for three years and \$100,000 thereafter, where actuarial equivalence is determined using a 5 percent interest rate and the applicable mortality table described in § 1.417(e)-1(d)(2) for the annuity starting date. In this case, the actuarially equivalent straight life annuity is \$102,180. Accordingly, with respect to this distribution stream, N's annual benefit is equal to \$102,180. The results are the same without regard to whether the Social Security supplement is a QSUPP (as defined in § 1.401(a)(4)-12).

*Example 4. (i) Facts.* Plan B is a defined benefit plan that provides a benefit equal to 100 percent of a participant's average compensation for the period of the participant's high-3 years of service, payable as a straight life annuity. For a married participant who does not elect another form of benefit, the benefit is payable in the form of a joint and 100 percent survivor annuity benefit that is a QJSA within the meaning of section 417 and that is reduced from the straight life annuity. For purposes of determining the amount of this QJSA, the plan provides that the reduction is only half of the reduction that would normally apply

under the actuarial assumptions specified in the plan for determining actuarial equivalence of optional forms. The plan also provides that a married participant can elect to receive the plan benefits as a straight life annuity, or in the form of a single sum distribution that is the actuarial equivalent of the joint and 100 percent survivor annuity determined using the applicable interest rate and the applicable mortality table under section 417(e)(3) and § 1.417(e)-1(d). Participant O elects, with spousal consent, a single-sum distribution.

(ii) *Conclusion.* The special rule that disregards the value of the survivor portion of a QJSA set forth in paragraph (c)(4)(i) of this section only applies to a benefit that is payable in the form of a qualified joint and survivor annuity. Any other form of benefit must be adjusted to a straight life annuity in accordance with paragraph (c)(1) of this section. Accordingly, because the benefit payable under the plan in the form of a single-sum distribution is actuarially equivalent to a straight life annuity that is greater than 100 percent of a participant's average compensation for the period of the participant's high-3 years of service, the limitation of section 415(b)(1)(B) has been exceeded.

*Example 5. (i) Facts.* Plan C is a defined benefit plan that provides an option to receive the benefit in the form of a joint and 100 percent survivor annuity with a 10-year certain feature, where the survivor beneficiary is the participant's spouse.

(ii) *Conclusion.* Since this form of benefit is not subject to section 417(e)(3), for a participant at age 65, the annual benefit with respect to the joint and 100 percent survivor annuity with a 10-year certain feature is determined for purposes of this section as the greater of the annual amount of the straight life annuity payable to the participant under the plan at age 65 (if any), or the annual amount of the straight life annuity commencing at age 65 that has the same actuarial present value as the joint and 100 percent survivor annuity with a 10-year certain feature (but excluding the survivor annuity payments pursuant to paragraph (c)(4)(i)(A) of this section), computing using a 5 percent interest assumption and the applicable mortality table described in § 1.417(e)-1(d)(2) for the annuity starting date. This latter amount is equal to the product of the annual payments under this optional form of benefit and the factor that provides for actuarial equivalence between a straight life annuity and a 10-year certain and life annuity (with no annuity for the survivor) computed using a 5 percent interest rate and the applicable mortality table described in § 1.417(e)-1(d)(2) for the annuity starting date.

*Example 6. (i) Facts.* Plan E provides a benefit at age 65 of a straight life annuity equal to the lesser of 90 percent of the participant's average compensation for the period of the participant's high-3 years of service and \$148,500. Upon retirement at age 65, the optional forms of benefit available to a participant include payment of a QJSA with annual payments equal to 50 percent of the annual payments under the straight life annuity, along with a single-sum distribution

that is actuarially equivalent (determined as the greater of the single sum calculated using a 5 percent interest assumption and the section 417(e)(3)(A)(ii)(I) mortality table in effect on January 1, 2003, and the single sum calculated using the section 417(e)(3)(A)(ii)(II) applicable interest rate and the section 417(e)(3)(A)(ii)(I) applicable mortality table for the distribution) to 50 percent of the annual payments under the straight life annuity. Participant Q retires at age 65. Q's average compensation for the period of Q's high-3 years of service is \$100,000. Q elects to receive a distribution in the optional form of benefit described above, under which the annual payments under the QJSA are \$45,000 and the single-sum distribution is equal to \$530,734. Q's spouse is 3 years younger than Q.

(ii) *Determination of annual benefit.* Q's annual benefit under Plan E for purposes of section 415(b) is determined as the sum of the annual benefit attributable to the QJSA portion of the distribution and the annual benefit attributable to the single-sum portion of the distribution.

(iii) *Annual benefit attributable to QJSA portion.* Because survivor benefits are not taken into account in determining the annual benefit attributable to the QJSA portion of the distribution, the annual benefit attributable to the QJSA portion of the distribution is determined as if that distribution were a straight life annuity of \$45,000 per year commencing at age 65. Thus, no form adjustment is needed to determine the annual benefit attributable to the QJSA portion of the distribution, and the annual benefit attributable to the QJSA portion of the benefit is \$45,000.

(iv) *Annual benefit attributable to single sum portion.* The annual benefit attributable to the single sum portion of the distribution is determined as the greatest of the annual amount of the actuarially equivalent straight life annuity commencing at the same age (determined using the plan's actuarial factors), the annual amount of the actuarially equivalent straight life annuity commencing at the same age (determined using a 5.5 percent interest assumption and the applicable mortality table under § 1.417(e)-1(d)(2) for the distribution), and the annual amount of the actuarially equivalent straight life annuity commencing at the same age (determined using the applicable interest rate and applicable mortality table under section 417(e)(3) and §§ 1.417(e)-1(d)(2) and (d)(3) for the distribution) divided by 1.05. With respect to the single-sum distribution, the annual amount of the actuarially equivalent straight life annuity commencing at the same age determined using the plan's actuarial factors is equal to \$45,954. The annual amount of the actuarially equivalent straight life annuity commencing at the same age determined using a 5.5 percent interest assumption and the applicable mortality table under § 1.417(e)-1(d)(2) for the distribution is \$46,912. The actuarially equivalent straight life annuity commencing at the same age determined using the applicable interest rate and the applicable mortality table under section 417(e)(3) and §§ 1.417(e)-1(d)(2) and (d)(3) for the distribution is equal to \$45,954. This amount

divided by 1.05 is equal to \$43,766. Thus, the annual benefit attributable to the single sum portion of the benefit is \$46,912.

(v) *Conclusion.* Q's annual benefit under the optional form of benefit for purposes of section 415(b) is equal to the sum of the annual benefit attributable to the QJSA portion of the distribution and the annual benefit attributable to the single sum portion of the distribution, or \$91,912. Because Q's average compensation for the period of Q's high-3 years of service is \$100,000, the distribution satisfies the compensation limit of section 415(b)(1)(B).

*Example 7. (i) Facts.* Plan D is a defined benefit plan with a normal retirement age of 65. The normal retirement benefit under Plan D (and the only life annuity available under Plan D) is a life annuity with a fixed increase of 2 percent per year. The increase applies to the benefit provided in the prior year and is thus compounded. The plan provides that the benefit is limited to the lesser of 84 percent of the participant's average compensation for the period of the participant's high-3 years of service or 84 percent of the age-adjusted section 415(b)(1)(A) dollar limit (which is assumed to be \$180,000 at age 65). Plan D does not incorporate the section 415(d) cost-of-living adjustments to the section 415(b) limits for limitation years following the limitation year in which a participant incurs a severance from employment. Participant P retires at age 65, at which time P's average compensation for the period of P's high-3 years of service is \$165,000. Under Plan D, P commences receiving benefits in the form of a life annuity of \$138,600 with a fixed increase of 2 percent per year.

(ii) *Conclusion.* Because Plan D does not provide for a straight life annuity and the form of benefit is not subject to section 417(e)(3), P's annual benefit for purposes of section 415(b) is the annual amount of the straight life annuity, commencing at age 65, that is actuarially equivalent to the distribution stream of \$138,600 with a fixed increase of 2 percent per year, where actuarial equivalence is determined using a 5 percent interest rate and the applicable mortality table for the distribution under section 417(e)(3) and § 1.417(e)-1(d)(2). In order to satisfy the requirements of section 415 and this section, this annual benefit must not exceed 100 percent of the average compensation for the period of the participant's high-3 years of service, or \$165,000. Using a 5 percent interest rate and the section 417(e)(3) applicable mortality table for the distribution, the actuarially equivalent straight life annuity is \$165,453, which exceeds \$165,000. Accordingly, the plan fails to satisfy the compensation-based limitation of section 415(b)(1)(B).

*Example 8. (i) Facts.* The facts are the same as in *Example 7*, except that Plan D incorporates by reference the section 415(d) cost-of-living adjustments to the section 415(b) limits as described in § 1.415(a)-1(d)(3)(v) and Plan D provides that the benefit is limited to the applicable section 415(b) limit. Under Plan D, P commences receiving benefits at age 65 in the form of a life annuity of \$138,221 with a fixed increase of 2 percent per year.



(ii) *Conclusion.* Because Plan D does not provide for a straight life annuity and the form of benefit is not subject to section 417(e)(3), P's annual benefit for purposes of section 415(b) is the annual amount of the straight life annuity, commencing at age 65, that is actuarially equivalent to the distribution stream of \$138,221 with a fixed increase of 2 percent per year, where actuarial equivalence is determined using a 5 percent interest rate and the applicable mortality table for P's annuity starting date under section 417(e)(3) and § 1.417(e)-1(d)(2). In order to satisfy the requirements of section 415(b) and this section, this annual benefit must not exceed 100 percent of P's average compensation for the period of P's high-3 years of service, or \$165,000. Using a 5 percent interest rate and the section 417(e)(3) applicable mortality table for the distribution, the actuarially equivalent straight life annuity is \$165,000, which does not exceed \$165,000. Accordingly, the plan satisfies the compensation-based limitation of section 415(b)(1)(B).

(iii) *Section 415(d) adjustments.* In addition to the fixed 2 percent per year automatic increase, P's benefit will be increased in limitation years following the limitation year in which P retires in accordance with the plan provisions that incorporate by reference the section 415(d) cost-of-living adjustments to the section 415(b) limits (or, if Plan D did not incorporate by reference the section 415(d) adjustments, P's benefit may be increased pursuant to plan amendments that comply with the safe harbors provided in § 1.415(d)-1(a)(5) or (6)), and such increases will not cause P's benefit to violate the requirements of section 415(b). For example, if in a later limitation year the applicable section 415(b) limit is increased by 3 percent pursuant to section 415(d) and § 1.415(d)-1, P's benefit payable under Plan D will be increased by both the fixed automatic 2 percent per year increase and by the 3 percent section 415(d) cost-of-living adjustment. The effect of the combined increases may result in P's benefits for a year exceeding the then applicable dollar limit under section 415(b), but the plan will not violate section 415(b).

*Example 9.* (i) *Facts.* The facts are the same as in *Example 7*, except that the plan provides that benefits are limited to the lesser of 100 percent of the participant's average compensation for the period of the participant's high-3 years of service or 100 percent of the age-adjusted section 415(b)(1)(A) dollar limit. Assume that P retires at age 65 with a benefit in the form of a life annuity of \$165,000 per year with a fixed increase of 2 percent per year. Additionally, assume that Plan D incorporates by reference the section 415(d) cost-of-living adjustments to the section 415(b) limits as described in § 1.415(a)-1(d)(3)(v) and the plan provides pursuant to paragraph (c)(5) of this section that in no event will a benefit payable from the plan, as increased by the fixed increase of 2 percent per year, be greater than the section 415(b) limit applicable as of the annuity starting date for the benefit (increased pursuant to the rules of section 415(d) and § 1.415(d)-1).

(ii) *Conclusion.* The benefit payable to P at age 65 is not required to be adjusted to take

into account the fixed increase of 2 percent per year. This is because the benefit payable to P satisfies the requirements of section 415(b) without regard to the fixed increase of 2 percent per year, and pursuant to paragraph (c)(5) of this section, the plan provides that the benefit payable to P, as increased by the fixed increase of 2 percent per year, will never be greater than the section 415(b) limit applicable as of P's annuity starting date (increased in subsequent limitation years pursuant to the rules of section 415(d) and § 1.415(d)-1).

(iii) *Section 415(d) adjustments.* In addition to the fixed 2 percent per year automatic increase, P's benefit will be increased in limitation years following the limitation year in which P retires in accordance with the plan provisions that incorporate by reference the section 415(d) cost-of-living adjustments to the section 415(b) limits (or, if Plan D did not incorporate by reference the section 415(d) adjustments, P's benefit may be increased pursuant to plan amendments that comply with the safe harbors provided in § 1.415(d)-1(a)(5) or (6)), and such increases will not cause P's benefit to violate the requirements of section 415(b). However, pursuant to paragraph (c)(5)(iii) of this section, P's benefit during any limitation year, as increased by the 2 percent per year automatic increase feature and any plan provisions that incorporate by reference the section 415(d) cost-of-living adjustments or any plan amendments that increase P's benefits, cannot exceed the then applicable section 415(b) limit (as increased pursuant to section 415(d) and § 1.415(d)-1).

*Example 10.* (i) *Facts.* Employer T maintains a defined benefit plan. Under the terms of the plan, all benefits in pay status (other than single sum payments) are adjusted upwards or downwards annually depending on an annual comparison of actual return on plan assets and an assumed interest rate of 4 percent. Thus, the plan does not offer a straight life annuity form of benefit, and the plan must determine for purposes of applying the section 415(b) limits the actuarially equivalent straight life annuity for benefits provided under the plan.

(ii) *Conclusion.* Benefits under the plan are paid in a form to which section 417(e)(3) does not apply. In determining the actuarially equivalent straight life annuity of benefits that are subject to the annual investment performance adjustment, the plan must assume a 5 percent return on plan assets. See paragraph (c)(2) of this section. Therefore, in determining the actuarially equivalent straight life annuity, the plan must assume that the form of benefit payable under the plan will be an annuity that increases annually by a factor equal to 1.05 divided by 1.04. This increasing annuity is then converted to an actuarially equivalent straight life annuity under paragraph (c)(2) of this section using a 5 percent interest rate and the applicable mortality table described in § 1.417(e)-1(d)(2) for the relevant annuity starting date.

*Example 11.* (i) *Facts.* R is a participant in a defined benefit plan maintained by R's employer. Under the terms of the plan, R must make contributions to the plan in a

stated amount to accrue benefits derived from employer contributions.

(ii) *Conclusion.* R's contributions are mandatory employee contributions within the meaning of section 411(c)(2)(C) and, thus, the annual benefit attributable to these contributions is not taken into account for purposes of testing the annual benefit derived from employer contributions against the applicable limitation on benefits. However, these contributions are treated as contributions to a defined contribution plan maintained by R's employer for purposes of section 415(c). See § 1.415(c)-1(a)(2)(ii)(B). Accordingly, with respect to the current limitation year, the limitation on benefits (as described in paragraph (a)(1) of this section) is applicable to the annual benefit attributable to employer contributions to the defined benefit plan, and the limitation on contributions and other additions (as described in § 1.415(c)-1) is applicable to the portion of the plan treated as a defined contribution plan, which consists of R's mandatory contributions. These same limitations would also apply if, instead of providing for mandatory employee contributions, the plan permitted voluntary employee contributions, because the portion of the plan attributable to voluntary employee contributions and earnings thereon is treated as a defined contribution plan maintained by the employer pursuant to section 414(k), and thus is not subject to the limitations of section 415(b).

*Example 12.* (i) *Facts.* V is a participant in a defined benefit plan maintained by V's employer. Under the terms of the plan, V must make contributions to the plan in a stated amount to accrue benefits derived from employer contributions. V's contributions are mandatory employee contributions within the meaning of section 411(c)(2)(C). Thus, the annual benefit attributable to these contributions is not taken into account for purposes of testing the annual benefit derived from employer contributions against the applicable limitation on benefits. V terminates employment and receives a distribution from the plan that includes V's mandatory employee contributions. Subsequently, V resumes employment with the employer maintaining the plan. V recommences participation in the plan and repays the prior distribution from the plan (including the portion of the distribution that included V's prior mandatory employee contributions to the plan) with reasonable interest.

(ii) *Conclusion.* In determining V's annual benefit under the plan for purposes of applying the limitations of section 415(b), no portion of V's repayment of the prior distribution is treated as employee contributions. See paragraphs (b)(2)(ii)(C), (D) and (E) of this section. However, V's annual benefit under the plan is determined by excluding the portion of the annual benefit attributable to V's employee contributions to the plan made both prior to the first distribution and during V's subsequent recommencement of plan participation.

(d) *Adjustment to section 415(b)(1)(A) dollar limit for commencement before age 62—(1) General rule—(i)*



*Calculation using statutory factors.* For a distribution with an annuity starting date that occurs before the participant attains the age of 62, the age-adjusted section 415(b)(1)(A) dollar limit generally is determined as the actuarial equivalent of the annual amount of a straight life annuity commencing at the annuity starting date that has the same actuarial present value as a deferred straight life annuity commencing at age 62, where annual payments under the straight life annuity commencing at age 62 are equal to the dollar limitation of section 415(b)(1)(A) (as adjusted pursuant to section 415(d) and § 1.415(d)-1 for the limitation year), and where the actuarially equivalent straight life annuity is computed using a 5 percent interest rate and the applicable mortality table under § 1.417(e)-1(d)(2) that is effective for that annuity starting date (and expressing the participant's age based on completed calendar months as of the annuity starting date). However, if the plan has an immediately commencing straight life annuity payable both at age 62 and the age of benefit commencement, then the age-adjusted section 415(b)(1)(A) dollar limit is equal to the lesser of—

(A) The limit as otherwise determined under this paragraph (d)(1)(i); and

(B) The amount determined under paragraph (d)(1)(ii) of this section.

(ii) *Calculation using plan factors.* The amount determined under this paragraph (d)(1)(ii) is equal to the section 415(b)(1)(A) dollar limit (as adjusted pursuant to section 415(d) and § 1.415(d)-1 for the limitation year) multiplied by the ratio of the annual amount of the immediately commencing straight life annuity under the plan to the annual amount of the straight life annuity under the plan commencing at age 62, with both annual amounts determined without applying the rules of section 415.

(2) *Mortality adjustments*—(i) *In general.* For purposes of determining the actuarially equivalent amount described in paragraph (d)(1)(i) of this section, to the extent that a forfeiture does not occur upon the participant's death before the annuity starting date, no adjustment is made to reflect the probability of the participant's death between the annuity starting date and the participant's attainment of age 62, unless the plan provides for such an adjustment. To the extent that a forfeiture occurs upon the participant's death before the annuity starting date, an adjustment must be made to reflect the probability of the participant's death between the annuity starting date and the participant's attainment of age 62.

(ii) *No forfeiture deemed to occur where qualified preretirement survivor annuity payable.* For purposes of paragraphs (d)(2)(i) and (e)(2)(i) of this section, a plan is permitted to treat no forfeiture as occurring upon a participant's death if the plan does not charge participants for providing a qualified preretirement survivor annuity (QPSA) (as defined in section 417(c)) on the participant's death, but only if the plan applies this treatment both for adjustments before age 62 and adjustments after age 65. Thus, in such a case, the plan is permitted to provide that, in computing the adjusted dollar limitation under section 415(b)(1)(A), no adjustment is made to reflect the probability of a participant's death after the annuity starting date and before age 62 or after age 65 and before the annuity starting date.

(3) *Exception for certain participants of certain governmental plans.* Pursuant to section 415(b)(2)(G) and (H), no age adjustment is made to the dollar limit for commencement before age 62 for any qualified participant. For this purpose, a qualified participant is a participant in a defined benefit plan that is maintained by a state, Indian tribal government (as defined in section 7701(a)(40)), or any political subdivision of a state or Indian tribal government with respect to whom the service taken into account in determining the amount of the benefit under the defined benefit plan includes at least 15 years of service of the participant—

(i) As a full-time employee of any police department or fire department that is organized and operated by the state, Indian tribal government, or political subdivision maintaining such defined benefit plan to provide police protection, firefighting services, or emergency medical services for any area within the jurisdiction of such state, Indian tribal government, or political subdivision; or

(ii) As a member of the Armed Forces of the United States.

(4) *Exception for survivor and disability benefits under governmental plans.* Pursuant to section 415(b)(2)(I), no age adjustment is made to the dollar limit for commencement before age 62 for a distribution from a governmental plan (as defined in section 414(d)) on account of the participant's becoming disabled by reason of personal injuries or sickness, or as a result of the death of the participant.

(5) *Special rule for commercial airline pilots.* Pursuant to section 415(b)(9), no age adjustment is made to the dollar limit for early commencement on or after age 60 for a participant if—

(i) The participant is a commercial airline pilot;

(ii) The participant separates from service upon or after attaining age 60; and

(iii) As of the time of the participant's retirement, regulations prescribed by the Federal Aviation Administration require an individual to separate from service as a commercial airline pilot after attaining any age occurring on or after age 60 and before age 62.

(6) *No decrease in age-adjusted section 415(b)(1)(A) dollar limit on account of age or service.*

Notwithstanding any other provision of this paragraph (d), the age-adjusted section 415(b)(1)(A) dollar limit applicable to a participant does not decrease on account of an increase in age or the performance of additional service.

(7) *Examples.* The following examples illustrate the application of this paragraph (d). For purposes of these examples, it is assumed that the dollar limitation under section 415(b)(1)(A) for all relevant years is \$180,000, that the normal form of benefit under the plan is a straight life annuity payable beginning at age 65, and that all payments other than a payment of a single sum are made monthly, on the first day of each calendar month. The examples are as follows:

*Example 1.* (i) Plan A provides that early retirement benefits are determined by reducing the accrued benefit by 4 percent for each year that the early retirement age is less than age 65. Participant M retires at age 60 with exactly 30 years of service with a benefit (prior to the application of section 415) in the form of a straight life annuity of \$100,000 payable at age 65, and is permitted to elect to commence benefits at any time between M's retirement and M's attainment of age 65. For example, M can elect to commence benefits at age 60 in the amount of \$80,000, can wait until age 62 and commence benefits in the amount of \$88,000, or can wait until age 65 and commence benefits in the amount of \$100,000. Plan A provides a QPSA to all married participants without charge. Plan A provides (consistent with paragraph (d)(2)(ii) of this section) that, for purposes of adjusting the dollar limitation under section 415(b)(1)(A) for commencement before age 62 or after age 65, no forfeiture is treated as occurring upon a participant's death before retirement and, therefore, in computing the adjusted dollar limitation under section 415(b)(1)(A), no adjustment is made to reflect the probability of a participant's death after the annuity starting date and before age 62 or after age 65 and before the annuity starting date.

(ii) The age-adjusted section 415(b)(1)(A) dollar limit that applies for commencement of M's benefit at age 60 is the lesser of the section 415(b)(1)(A) dollar limit multiplied by the ratio of the annuity payable at age 60 to the annuity payable at age 62, or the

straight life annuity payable at age 60 that is actuarially equivalent, using 5 percent interest and the applicable mortality table effective for that annuity starting date under section 417(e)(3)(A)(ii)(I) and § 1.417(e)–1(d)(2), to the deferred annuity payable at age 62 of \$180,000 per year. In this case, the age-adjusted section 415(b)(1)(A) dollar limit at age 60 is \$156,229 (the lesser of \$163,636 (\$180,000\* \$80,000/\$88,000) and \$156,229 (the straight life annuity at age 60 that is actuarially equivalent to a deferred annuity of \$180,000 commencing at age 62, determined using 5 percent interest and the applicable mortality table, without a mortality decrement for the period between 60 and 62)).

*Example 2.* (i) The facts are the same as in *Example 1*, except that participant M elects to retire at age 60, 6 months, and 21 days.

(ii) Under paragraph (d)(1)(i) of this section, M is treated as age 60 and 6 months (or, age 60.5). Absent the rule provided in paragraph (d)(6) of this section, the age-adjusted section 415(b)(1)(A) dollar limit that applies for commencement of M's benefit at age 60.5 is the lesser of the section 415(b)(1)(A) dollar limit multiplied by the ratio of the annuity payable at age 60.5 to the annuity payable at age 62, or the straight life annuity payable at age 60.5 that is actuarially equivalent, using 5 percent interest and the applicable mortality table for that annuity starting date under section 417(e)(3)(A)(ii)(I) and § 1.417(e)–1(d)(2), to the deferred annuity payable at age 62 of \$180,000 per year. The age-adjusted section 415(b)(1)(A) dollar limit at age 60.5 is \$161,769 (the lesser of \$167,727 (\$180,000\* \$82,000/\$88,000) and \$161,769 (the straight life annuity at age 60.5 that is actuarially equivalent to a deferred annuity of \$180,000 commencing at age 62, determined using 5 percent interest and the applicable mortality table, without a mortality decrement for the period between 60.5 and 62)).

*Example 3.* (i) The facts are the same as in *Example 1*, except the plan provides that, if a participant has 30 or more years of service, no reduction applies for benefits commencing at age 62 and later.

(ii) Absent the rule provided in paragraph (d)(6) of this section, the age-adjusted section 415(b)(1)(A) dollar limit that applies for commencement of M's benefit at age 60 is the lesser of the section 415(b)(1)(A) dollar limit multiplied by the ratio of the annuity payable at age 60 to the annuity payable at age 62, or the straight life annuity payable at age 60 that is actuarially equivalent, using 5 percent interest and the applicable mortality table for that annuity starting date under section 417(e)(3)(A)(ii)(I) and § 1.417(e)–1(d)(2), to the deferred annuity payable at age 62 of \$180,000 per year. In this case, because M has 30 years of service and would be eligible for the unreduced early retirement benefit at age 62, the age-adjusted section 415(b)(1)(A) dollar limit at age 60 would be \$144,000 (the lesser of \$144,000 (\$180,000\* \$80,000/\$100,000) and \$156,229 (the straight life annuity at age 60 that is actuarially equivalent to a deferred annuity of \$180,000 commencing at age 62, determined using 5 percent interest and the applicable mortality table, without a mortality decrement for the period between 60 and 62)).

(iii) However, at age 59 11/12 with 29 11/12 years of service, the age-adjusted section 415(b)(1)(A) dollar limit for M is \$155,311 (the lesser of \$162,955 (\$180,000\* \$79,667/\$88,000) and \$155,311 (the straight life annuity at age 59 11/12 that is actuarially equivalent to a deferred annuity of \$180,000 commencing at age 62, determined using 5 percent interest and the applicable mortality table, without a mortality decrement for the period between 59 and 62)). Thus, after applying the rule provided in paragraph (d)(6) of this section, the age-adjusted section 415(b)(1)(A) dollar limit that applies for commencement of M's benefit at age 60 is \$155,311.

*Example 4.* (i) The facts are the same as in *Example 1*, except that the plan provides that, if a participant has 30 or more years of service, then no reduction is made in early retirement benefits if the early retirement age is at least age 62 and, in the case of an early retirement age before age 62, the early retirement benefit is determined by reducing the accrued benefit by 4 percent for each year that the early retirement age is less than age 62.

(ii) The age-adjusted section 415(b)(1)(A) dollar limit that applies for commencement of M's benefit at age 60 is the lesser of the section 415(b)(1)(A) dollar limit multiplied by the ratio of the annuity payable at age 60 to the annuity payable at age 62, or the straight life annuity payable at age 60 that is actuarially equivalent, using 5 percent interest and the applicable mortality table for that annuity starting date under section 417(e)(3)(A)(ii)(I) and § 1.417(e)–1(d)(2), to the deferred annuity payable at age 62 of \$180,000 per year. In this case, because M has 30 years of service and would be eligible for the unreduced early retirement benefit at age 62, the age-adjusted section 415(b)(1)(A) dollar limit at age 60 is \$156,229 (the lesser of \$165,600 (\$180,000\* \$92,000/\$100,000) and \$156,229 (the straight life annuity at age 60 that is actuarially equivalent to a deferred annuity of \$180,000 commencing at age 62, determined using 5 percent interest and the applicable mortality table, without a mortality decrement for the period between 60 and 62)).

*Example 5.* (i) The facts are the same as in *Example 1*, except that Participant M chooses to receive benefits in the form of a 10-year certain and life annuity under which payments are 97 percent of the periodic payments that would be made under the immediately commencing straight life annuity. Annual payments to M are 97 percent of \$80,000, or \$77,600. Additionally, M's average compensation for the period of M's high-3 years of service is \$120,000. As in *Example 1*, the age-adjusted section 415(b)(1)(A) dollar limit at age 60 is \$156,229.

(ii) In the case of a form of benefit to which section 417(e)(3) does not apply, the annual benefit for purposes of this section is the greater of the annual amount of the plan's straight life annuity commencing at the same age or the annual amount of the actuarially equivalent straight life annuity commencing at the same age, determined using a 5 percent interest rate and the applicable mortality table for that annuity starting date under

section 417(e)(3)(A)(ii)(I) and § 1.417(e)–1(d)(2). In this case, the straight life annuity payable under the plan commencing at the same age is \$80,000. The annual amount of the straight life annuity that is actuarially equivalent to the \$77,600 benefit payable as a 10-year certain and life annuity is determined by applying the required standardized factors (a 5 percent interest assumption and the applicable mortality under section 417(e)(3)(A)(ii)(I) and § 1.417(e)–1(d)(2), and is \$79,416. With respect to the 10-year certain and life annuity commencing at age 62, M's annual benefit is equal to the greater of the two resulting amounts (\$80,000 and \$79,416), or \$80,000. Because M's annual benefit is less than the age-adjusted section 415(b)(1)(A) dollar limit and is less than the section 415(b)(1)(B) compensation limit, M's benefit satisfies section 415.

*Example 6.* (i) Participant O is a full-time civilian employee of the Harbor Police Division of the State of X Port Authority. The Harbor Police Division provides police protection services. O performs clerical services for the Harbor Police Division. O is a participant in the defined benefit plan that is maintained by the State of X with respect to whom the years of service taken into account in determining the amount of the benefit under the plan includes 10 years of service working for the Harbor Police Division and 5 years of service as a member of the Armed Forces of the United States.

(ii) For a distribution with an annuity starting date that occurs before O attains the age of 62, there is no age adjustment to the section 415(b)(1)(A) dollar limit.

*Example 7.* (i) Participant R is a full-time employee of the Emergency Medical Service Department of County Y (which is not a part of a police or fire department) who performs services as a driver of an ambulance. R is a participant in the defined benefit plan that is maintained by County Y with respect to whom the years of service taken into account in determining the amount of the benefit under the plan includes 15 years of service working for County Y. R does not have service credit for time in the Armed Forces of the United States.

(ii) The age adjustments to the limitations of section 415(b)(1)(A) pursuant to section 415(b)(2)(C) and (D) will apply if R commences receiving a distribution at an age to which either of those adjustments applies.

(e) *Adjustment to section 415(b)(1)(A) dollar limit for commencement after age 65—(1) General rule—(i) Calculation using statutory factors.* For a distribution with an annuity starting date that occurs after the participant attains the age of 65, the age-adjusted section 415(b)(1)(A) dollar limit generally is determined as the actuarial equivalent of the annual amount of a straight life annuity commencing at the annuity starting date that has the same actuarial present value as a straight life annuity commencing at age 65, where annual payments under the straight life annuity commencing at age 65 are equal to the dollar limitation of section

415(b)(1)(A) (as adjusted pursuant to section 415(d) and § 1.415(d)-1 for the limitation year), and where the actuarially equivalent straight life annuity is computed using a 5 percent interest rate and the applicable mortality table under § 1.417(e)-1(d)(2) that is effective for that annuity starting date (and expressing the participant's age based on completed calendar months as of the annuity starting date). However, if the plan has an immediately commencing straight life annuity payable as of the annuity starting date and an immediately commencing straight life annuity payable at age 65, then the age-adjusted section 415(b)(1)(A) dollar limit is equal to the lesser of—

(A) The limit as otherwise determined under this paragraph (e)(1)(i); and

(B) The amount determined under paragraph (e)(1)(ii) of this section.

(ii) *Calculation using plan factors.* The amount determined under this paragraph (e)(1)(ii) is equal to the section 415(b)(1)(A) dollar limit (as adjusted pursuant to section 415(d) and § 1.415(d)-1 for the limitation year) multiplied by the adjustment ratio described in paragraph (e)(2)(i) of this section.

(2) *Adjustment ratio*—(i) *General rule.* For purposes of applying the rule of paragraph (e)(1)(ii) of this section, the adjustment ratio is equal to the ratio of the annual amount of the adjusted immediately commencing straight life annuity under the plan described in paragraph (e)(2)(ii) of this section to the adjusted age 65 straight life annuity described in paragraph (e)(2)(iii) of this section.

(ii) *Adjusted immediately commencing straight life annuity.* The adjusted immediately commencing straight life annuity that is used for purposes of paragraph (e)(2)(i) of this section is the annual amount of the immediately commencing straight life annuity payable to the participant, computed disregarding the participant's accruals after age 65 but including actuarial adjustments even if those actuarial adjustments are applied to offset accruals. For this purpose, the annual amount of the immediately commencing straight life annuity is determined without applying the rules of section 415.

(iii) *Adjusted age 65 straight life annuity.* The adjusted age 65 straight life annuity that is used for purposes of paragraph (e)(2)(i) of this section is the annual amount of the straight life annuity that would be payable under the plan to a hypothetical participant who is 65 years old and has the same accrued benefit (with no actuarial

increases for commencement after age 65) as the participant receiving the distribution (determined disregarding the participant's accruals after age 65 and without applying the rules of section 415).

(3) *Mortality adjustments*—(i) *In general.* For purposes of determining the actuarially equivalent amount described in paragraph (e)(1)(i) of this section, to the extent that a forfeiture does not occur upon the participant's death before the annuity starting date, no adjustment is made to reflect the probability of the participant's death between the participant's attainment of age 65 and the annuity starting date. To the extent that a forfeiture occurs upon the participant's death before the annuity starting date, an adjustment must be made to reflect the probability of the participant's death between the participant's attainment of age 65 and the annuity starting date.

(ii) *No forfeiture deemed to occur where QPSA payable.* See paragraph (d)(2)(ii) of this section for a rule deeming no forfeiture to occur if the plan does not charge participants for providing a QPSA on the participant's death.

(4) *Examples.* The following examples illustrate the application of this paragraph (e):

*Example 1.* (i) Plan A provides that monthly benefits payable upon commencement after normal retirement age (which is age 65) are increased by 0.5 percent for each month of delay in commencement after attainment of normal retirement age. Plan A provides a QPSA to all married participants without charge. Plan A provides (consistent with paragraph (d)(2)(ii) of this section) that, for purposes of adjusting the dollar limitation under section 415(b)(1)(A) for commencement before age 62 or after age 65, no adjustment is made to reflect the probability of a participant's death between the annuity starting date and the participant's attainment of age 62 or between the age of 65 and the annuity starting date. The normal form of benefit under Plan A is a straight life annuity commencing at age 65. Plan A does not provide additional benefit accruals once a participant is credited with 30 years of service. Participant M was credited with 30 years of service under Plan A when M attained age 65. M retires at age 70 on January 1, 2008, with a benefit (prior to the application of section 415) that is payable monthly in the form of a straight life annuity of \$195,000, which reflects the actuarial increase of 30 percent applied to the accrued benefit of \$150,000. It is assumed that all payments under Plan A, other than a payment of a single sum, are made monthly, on the first day of each calendar month. It is also assumed that the dollar limit in 2008 is \$185,000.

(ii) The age-adjusted section 415(b)(1)(A) dollar limit at age 70 is the lesser of the section 415(b)(1)(A) dollar limit multiplied

by the ratio of the adjusted immediately commencing straight life annuity payable at age 70 (computed disregarding the rules of section 415 and accruals after age 65, but including actuarial adjustments) to the adjusted age 65 straight life annuity (computed disregarding the rules of section 415 and any accruals after age 65), or the straight life annuity payable at age 70 that is actuarially equivalent, using 5 percent interest and the applicable mortality table for that annuity starting date under section 417(e)(3)(A)(ii)(I) and § 1.417(e)-1(d)(2), to the straight life annuity payable at age 65, where annual payments under the straight life annuity payable at age 65 are equal to the dollar limitation of section 415(b)(1)(A). In this case, the age-adjusted section 415(b)(1)(A) dollar limit at age 70 is \$240,500 (the lesser of \$240,500 (\$185,000 \* \$195,000 / \$150,000) and \$271,444 (the straight life annuity at age 70 that is actuarially equivalent to an annuity of \$185,000 commencing at age 65, determined using 5 percent interest and the applicable mortality table, without a mortality decrement for the period between 65 and 70)).

*Example 2.* (i) The facts are the same as in Example 1, except that Plan A does not limit benefit accruals to 30 years of credited service, and thus M accrues benefits between ages 65 and 70.

(ii) Since M's accruals after attaining age 65 are disregarded for purposes of determining the age-adjusted section 415(b)(1)(A) dollar limit applicable to M at age 70, the result is the same as in Example 1.

*Example 3.* (i) The facts are the same as in Example 1, except that Plan A does not limit benefit accruals to 30 years of credited service. However, benefit accruals after an employee has reached normal retirement age (age 65), are offset by the actuarial increase that the plan provides for commencement of benefits after normal retirement age.

(ii) The result is the same as in Example 1, even if the actuarial increases for post-age 65 benefit commencement provided under Plan A do or do not fully offset M's benefit accruals after attaining age 65. This is because benefit accruals after age 65 are disregarded for purposes of determining the age-adjusted section 415(b)(1)(A) dollar limit applicable to M after age 65.

(f) *Total annual payments not in excess of \$10,000*—(1) *In general.* Pursuant to section 415(b)(4), the annual benefit (without regard to the age at which benefits commence) payable with respect to a participant under any defined benefit plan is not considered to exceed the limitations on benefits described in section 415(b)(1) and in paragraph (a)(1) of this section if—

(i) The benefits (other than benefits not taken into account in the computation of the annual benefit under the rules of paragraph (b) or (c) of this section) payable with respect to the participant under the plan and all other defined benefit plans of the employer do not in the aggregate exceed \$10,000 (as adjusted under paragraph (g) of this

section) for the limitation year, or for any prior limitation year; and

(ii) The employer (or a predecessor employer) has not at any time maintained a defined contribution plan in which the participant participated.

(2) *Computation of benefits for purposes of applying the \$10,000 amount.* For purposes of paragraph (f)(1)(i) of this section, the benefits payable with respect to the participant under a plan for a limitation year reflect all amounts payable under the plan for the limitation year (other than benefits not taken into account in the computation of the annual benefit under the rules of paragraph (b) or (c) of this section), and are not adjusted for form of benefit or commencement date.

(3) *Special rule with respect to participants in multiemployer plans.* The special \$10,000 exception set forth in paragraph (f)(1) of this section applies to a participant in a multiemployer plan described in section 414(f) without regard to whether that participant ever participated in one or more other plans maintained by an employer who also maintains the multiemployer plan, provided that none of such other plans were maintained as a result of collective bargaining involving the same employee representative as the multiemployer plan.

(4) *Special rule with respect to employee contributions.*

Notwithstanding §§ 1.415(c)–1(a)(2)(ii)(B) and 1.415(c)–1(b)(3), mandatory employee contributions under a defined benefit plan described in paragraph (b)(2)(iii) of this section are not considered a separate defined contribution plan maintained by the employer for purposes of paragraph (f)(1)(ii) of this section. Thus, the special dollar limitation provided for in this paragraph (f) applies to a contributory defined benefit plan.

Similarly, for purposes of this paragraph (f), an individual medical account under section 401(h) or an account for postretirement medical benefits established pursuant to section 419A(d)(1) is not considered a separate defined contribution plan maintained by the employer.

(5) *Examples.* The application of this paragraph (f) may be illustrated by the following examples. For purposes of these examples, it is assumed that each participant has 10 years of participation in the plan and service with the employer. The examples are as follows:

*Example 1.* (i) B is a participant in a defined benefit plan maintained by X Corporation, which provides for a benefit payable in the form of a straight life annuity beginning at age 65. B's average compensation for the period of B's high-3

years of service is \$6,000. The plan does not provide for mandatory employee contributions, and at no time has B been a participant in a defined contribution plan maintained by X. With respect to the current limitation year, B's benefit under the plan (before the application of section 415) is \$9,500.

(ii) Because annual payments under B's benefit do not exceed \$10,000, and because B has at no time participated in a defined contribution plan maintained by X, the benefits payable under the plan are not considered to exceed the limitation on benefits otherwise applicable to B (\$6,000).

(iii) This result would remain the same even if, under the terms of the plan, B's benefit of \$9,500 were payable at age 60, or if the plan provided for mandatory employee contributions.

*Example 2.* (i) The facts are the same as in *Example 1*, except that the plan provides for a benefit payable in the form of a life annuity with a 10-year certain feature with annual payments of \$9,500. Assume that, after the adjustment described in paragraph (c) of this section, B's actuarially equivalent straight life annuity (which is the annual benefit used for demonstrating compliance with section 415) for the current limitation year is \$10,400.

(ii) For purposes of applying the special rule provided in this paragraph for total benefits not in excess of \$10,000, there is no adjustment required if the retirement benefit payable under the plan is not in the form of a straight life annuity. Therefore, because B's retirement benefit does not exceed \$10,000, B may receive the full \$9,500 benefit without the otherwise applicable benefit limitations of this section being exceeded.

*Example 3.* (i) The facts are the same as in *Example 1*, except that the plan provides for a benefit payable in the form of a single sum and the amount of the single sum that is the actuarial equivalent of the straight life annuity payable to B (\$9,500 annually), determined in accordance with the rules of section 417(e)(3) and § 1.417(e)–1(d), is \$95,000.

(ii) Because the amount payable to B for the limitation year would exceed \$10,000, the rule of this paragraph (f) does not provide an exception from the generally applicable limits of section 415(b)(1) for the single-sum distribution. Thus, the otherwise applicable limits apply to the single-sum distribution, and a single-sum distribution of \$95,000 would not satisfy the requirements of section 415(b). Limiting the single-sum distribution to \$60,000 (the present value of the annuity that complies with the compensation-based limitation of section 415(b)(1)(B)) in order to satisfy section 415 would be an impermissible forfeiture under the requirements of section 411(a). Accordingly, the plan should not provide for a single-sum distribution in these circumstances.

(g) *Special rule for participation or service of less than 10 years—(1) Proration of dollar limit based on years of participation—(i) In general.* Pursuant to section 415(b)(5)(A), where a participant has less than 10 years of participation in the plan, the dollar limit described in paragraph (a)(1)(i) of

this section (as adjusted pursuant to section 415(d), § 1.415(d)–1, and paragraphs (d) and (e) of this section) is reduced by multiplying the otherwise applicable limitation by a fraction—

(A) The numerator of which is the number of years of participation in the plan (or 1, if greater); and

(B) The denominator of which is 10.

(ii) *Years of participation.* The following rules apply for purposes of determining a participant's years of participation for purposes of this paragraph (g)(1)—

(A) A participant is credited with a year of participation (computed to fractional parts of a year) for each accrual computation period for which the participant is credited with at least the number of hours of service (or period of service if the elapsed time method is used for benefit accrual purposes) required under the terms of the plan in order to accrue a benefit for the accrual computation period, and the participant is included as a plan participant under the eligibility provisions of the plan for at least one day of the accrual computation period. If these two conditions are met, the portion of a year of participation credited to the participant is equal to the amount of benefit accrual service credited to the participant for such accrual computation period. For example, if under the terms of a plan, a participant receives 1/10 of a year of benefit accrual service for an accrual computation period for each 200 hours of service, and the participant is credited with 1,000 hours of service for the period, the participant is credited with 1/2 a year of participation for purposes of section 415(b)(5)(A) and this paragraph (g)(1).

(B) A participant who is permanently and totally disabled within the meaning of section 415(c)(3)(C)(i) for an accrual computation period is credited with a year of participation with respect to that period for purposes of section 415(b)(5)(A) and this paragraph (g)(1).

(C) For a participant to receive a year of participation (or part thereof) for an accrual computation period for purposes of section 415(b)(5)(A) and this paragraph (g)(1), the plan must be established no later than the last day of such accrual computation period.

(D) No more than one year of participation may be credited for any 12-month period for purposes of section 415(b)(5)(A) and this paragraph (g)(1).

(2) *Proration of compensation limit and special rule for total annual payments less than \$10,000 based on years of service—(i) In general.* Pursuant to section 415(b)(5)(B), where a participant has less than 10 years of

service with the employer, the compensation limit described in paragraph (a)(1)(ii) of this section and the \$10,000 amount under the special rule for small annual payments under paragraph (f) of this section are reduced by multiplying the otherwise applicable limitation by a fraction—

(A) The numerator of which is the number of years of service with the employer (or 1, if greater); and

(B) The denominator of which is 10.

(ii) *Years of service*—(A) *In general.* For purposes of applying this paragraph (g)(2), years of service must be determined on a reasonable and consistent basis. A plan is considered to be determining years of service on a reasonable and consistent basis for this purpose if, subject to the limits of paragraph (g)(2)(ii)(B) of this section, a participant is credited with a year of service (computed to fractional parts of a year) for each accrual computation period for which the participant is credited with at least the number of hours of service (or period of service if the elapsed time method is used for benefit accrual purposes) required under the terms of the plan in order to accrue a benefit for the accrual computation period.

(B) *Rules of application.* No more than one year of service may be credited for any 12-month period for purposes of section 415(b)(5)(B). In addition, only the participant's service with the employer or a predecessor employer (as defined in § 1.415(f)–1(c)) may be taken into account in determining the participant's years of service for this purpose. Thus, if an employer does not maintain a former employer's plan, a participant's service with the former employer may be taken into account in determining the participant's years of service for purposes of this paragraph (g)(2) only if the former employer is a predecessor employer with respect to the employer pursuant to § 1.415(f)–1(c)(2) (which defines predecessor employer to include, under certain circumstances, a former entity that antedates the employer).

(C) *Period of disability.*

Notwithstanding the rules of paragraph (g)(2)(ii)(B) of this section, a plan is permitted to provide that a participant who is permanently and totally disabled within the meaning of section 415(c)(3)(C)(i) for an accrual computation period is credited with service with respect to that period for purposes of section 415(b)(5)(B).

(3) *Exception for survivor and disability benefits under governmental plans.* The requirements of this paragraph (g) (regarding participation or service of less than 10 years) do not

apply to a distribution from a governmental plan (as defined in section 414(d)) on account of the participant's becoming disabled by reason of personal injuries or sickness, or as a result of the death of the participant.

(4) *Examples.* The provisions of this paragraph (g) may be illustrated by the following examples:

*Example 1.* (i) C begins employment with Employer A on January 1, 2005, at the age of 58. Employer A maintains only a noncontributory defined benefit plan which provides for a straight life annuity beginning at age 65 and uses the calendar year for the limitation and plan year. Employer A has never maintained a defined contribution plan. C becomes a participant in Employer A's plan on January 1, 2006, and works through December 31, 2011, when C is age 65. C begins to receive benefits under the plan in 2012. C's average compensation for the period of C's high-3 years of service is \$40,000. Furthermore, under the terms of Employer A's plan, for purposes of computing C's nonforfeitable percentage in C's accrued benefit derived from employer contributions, C has only 7 years of service with Employer A (2005–2011).

(ii) Because C has only 7 years of service with Employer A at the time he begins to receive benefits under the plan, the maximum permissible annual benefit payable with respect to C is \$28,000 (\$40,000 multiplied by 7/10).

*Example 2.* (i) The facts are the same as in *Example 1*, except that C's average compensation for the period of his high-3 years of service is \$8,000.

(ii) Because C has only 7 years of service with Employer A at the time he begins to receive benefits, the maximum benefit payable with respect to C would be reduced to \$5,600 (\$8,000 multiplied by 7/10). However, the special rule for total benefits not in excess of \$10,000, provided in paragraph (f) of this section, is applicable in this case. Accordingly, C may receive an annual benefit of \$7,000 (\$10,000 multiplied by 7/10) without the benefit limitations of this section being exceeded.

*Example 3.* (i) Employer B maintains a defined benefit plan. Benefits under the plan are computed based on months of service rather than years of service. Accordingly, for purposes of applying the reduction based on years of service less than 10 to the limitations under section 415(b), the plan provides that the otherwise applicable limitation is multiplied by a fraction, the numerator of which is the number of completed months of service with the employer (but not less than 12 months), and the denominator of which is 120. The plan further provides that months of service are computed in the same manner for this purpose as for purposes of computing plan benefits.

(ii) The manner in which the plan applies the reduction based on years of service less than 10 to the limitations under section 415(b) is consistent with the requirements of this paragraph (g).

*Example 4.* (i) G begins employment with Employer D on January 1, 2003, at the age of

58. Employer D maintains a noncontributory defined benefit plan which provides for a straight life annuity beginning at age 65 and uses the calendar year for the limitation and plan year. G becomes a participant in Employer D's plan on January 1, 2004, and works through December 31, 2009, when G is age 65. G performs sufficient service to be credited with a year of service under the plan for each year during 2003 through 2009 (although G is not credited with a year of service for 2003 because G is not yet a plan participant). G begins to receive benefits under the plan during 2010. The plan's accrual computation period is the plan year. The plan provides that, for purposes of applying the rules of section 415(b)(5)(B), a participant is credited with a year of service (computed to fractional parts of a year) for each plan year for which the participant is credited with sufficient service to accrue a benefit for the plan year. G's average compensation for the period of G's high-3 years of service is \$200,000. It is assumed for purposes of this example that the dollar limitation of section 415(b)(1)(A) for limitation years ending in 2010 is \$195,000.

(ii) G has 7 years of service and 6 years of participation in the plan at the time G begins to receive benefits under the plan. Accordingly, the limitation under section 415(b)(1)(B) based on G's average compensation for the period of G's high-3 years of service that applies pursuant to the adjustment required under section 415(b)(5)(B) is \$140,000 (\$200,000 multiplied by 7/10), and the dollar limitation under section 415(b)(1)(A) that applies to G pursuant to the adjustment required under section 415(b)(5)(A) is \$117,000 (\$195,000 multiplied by 6/10).

(h) *Retirement Protection Act of 1994 transition rules.* For special rules affecting the actuarial adjustment for form of benefit under paragraph (c) of this section and the adjustment to the dollar limit for early or late commencement under paragraphs (d) and (e) of this section for certain plans adopted and in effect before December 8, 1994, see section 767(d)(3)(A) of the Uruguay Round Agreements Act of 1994, Public Law 103–465 (108 Stat. 4809) as amended by section 1449(a) of the Small Business Job Protection Act of 1996, Public Law 104–188 (110 Stat. 1755). The Commissioner may provide guidance regarding these special rules in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin. See § 601.601(d) of this chapter.

■ **Par. 10.** Section 1.415(b)–2 is added and reserved.

§ 1.415(b)–2 Multiple annuity starting dates. [Reserved].

■ **Par. 11.** Section 1.415(c)–1 is added to read as follows:

**§ 1.415(c)-1 Limitations for defined contribution plans.**

(a) *General rules*—(1) *Maximum limitations*. Under section 415(c) and this section, to satisfy the provisions of section 415(a) for any limitation year, except as provided by paragraph (a)(3) of this section, the annual additions (as defined in paragraph (b) of this section) credited to the account of a participant in a defined contribution plan for the limitation year must not exceed the lesser of—

(i) \$40,000 (adjusted pursuant to section 415(d) and § 1.415(d)-1(b)); or  
(ii) 100 percent of the participant's compensation (as defined in § 1.415(c)-2) for the limitation year.

(2) *Defined contribution plan*—(i) *Definition*. For purposes of section 415 and regulations promulgated under section 415, the term *defined contribution plan* means a defined contribution plan within the meaning of section 414(i) (including the portion of a plan treated as a defined contribution plan under the rules of section 414(k)) that is—

(A) A plan described in section 401(a) which includes a trust which is exempt from tax under section 501(a);

(B) An annuity plan described in section 403(a); or

(C) A simplified employee pension described in section 408(k).

(ii) *Additional plans treated as defined contribution plans*—(A) *In general*. Contributions to the types of arrangements described in paragraphs (a)(2)(ii)(B) through (D) of this section are treated as contributions to defined contribution plans for purposes of section 415 and regulations promulgated under section 415.

(B) *Employee contributions to a defined benefit plan*. Mandatory employee contributions (as defined in section 411(c)(2)(C) and § 1.411(c)-1(c)(4), regardless of whether the plan is subject to the requirements of section 411) to a defined benefit plan are treated as contributions to a defined contribution plan. For this purpose, contributions that are picked up by the employer as described in section 414(h)(2) are not considered employee contributions.

(C) *Individual medical benefit accounts under section 401(h)*. Pursuant to section 415(l)(1), contributions allocated to any individual medical benefit account which is part of a pension or annuity plan established pursuant to section 401(h) are treated as contributions to a defined contribution plan.

(D) *Post-retirement medical accounts for key employees*. Pursuant to section 419A(d)(2), amounts attributable to

medical benefits allocated to an account established for a key employee (any employee who, at any time during the plan year or any preceding plan year, is or was a key employee as defined in section 416(i)) pursuant to section 419A(d)(1) are treated as contributions to a defined contribution plan.

(iii) *Section 403(b) annuity contracts*. Annual additions under an annuity contract described in section 403(b) are treated as annual additions under a defined contribution plan for purposes of this section.

(3) *Alternative contribution limitations*—(i) *Church plans*. For alternative contribution limitations relating to church plans, see paragraph (d) of this section.

(ii) *Special rules for medical benefits*. For additional rules relating to certain medical benefits, see paragraph (e) of this section.

(iii) *Employee stock ownership plans*. For additional rules relating to employee stock ownership plans, see paragraph (f) of this section.

(b) *Annual additions*—(1) *In general*—(i) *General definition*. The term *annual addition* means, for purposes of this section, the sum, credited to a participant's account for any limitation year, of—

(A) Employer contributions;

(B) Employee contributions; and

(C) Forfeitures.

(ii) *Certain excess amounts treated as annual additions*. Contributions do not fail to be annual additions merely because they are excess contributions (as described in section 401(k)(8)(B)) or excess aggregate contributions (as described in section 401(m)(6)(B)), or merely because excess contributions or excess aggregate contributions are corrected through distribution.

(iii) *Direct transfers*. The direct transfer of a benefit or employee contributions from a qualified plan to a defined contribution plan does not give rise to an annual addition.

(iv) *Reinvested employee stock ownership plan dividends*. The reinvestment of dividends on employer securities under an employee stock ownership plan pursuant to section 404(k)(2)(A)(iii)(II) does not give rise to an annual addition.

(2) *Employer contributions*—(i) *Amounts treated as an annual addition*. For purposes of paragraph (b)(1)(i)(A) of this section, the term *annual addition* includes employer contributions credited to the participant's account for the limitation year and other allocations described in paragraph (b)(4) of this section that are made during the limitation year. See paragraph (b)(6) of this section for timing rules applicable

to annual additions with respect to employer contributions.

(ii) *Amounts not treated as annual additions*—(A) *Certain restorations of accrued benefits*. The restoration of an employee's accrued benefit by the employer in accordance with section 411(a)(3)(D) or section 411(a)(7)(C) or resulting from the repayment of cashouts (as described in section 415(k)(3)) under a governmental plan (as defined in section 414(d)) is not considered an annual addition for the limitation year in which the restoration occurs. This treatment of a restoration of an employee's accrued benefit as not giving rise to an annual addition applies regardless of whether the plan restricts the timing of repayments to the maximum extent allowed by section 411(a).

(B) *Catch-up contributions*. A catch-up contribution made in accordance with section 414(v) and § 1.414(v)-1 does not give rise to an annual addition.

(C) *Restorative payments*. A restorative payment that is allocated to a participant's account does not give rise to an annual addition for any limitation year. For this purpose, restorative payments are payments made to restore losses to a plan resulting from actions by a fiduciary for which there is reasonable risk of liability for breach of a fiduciary duty under Title I of the Employee Retirement Income Security Act of 1974 (88 Stat. 829), Public Law 93-406 (ERISA) or under other applicable federal or state law, where plan participants who are similarly situated are treated similarly with respect to the payments. Generally, payments to a defined contribution plan are restorative payments only if the payments are made in order to restore some or all of the plan's losses due to an action (or a failure to act) that creates a reasonable risk of liability for such a breach of fiduciary duty (other than a breach of fiduciary duty arising from failure to remit contributions to the plan). This includes payments to a plan made pursuant to a Department of Labor order, the Department of Labor's Voluntary Fiduciary Correction Program, or a court-approved settlement, to restore losses to a qualified defined contribution plan on account of the breach of fiduciary duty (other than a breach of fiduciary duty arising from failure to remit contributions to the plan). Payments made to a plan to make up for losses due merely to market fluctuations and other payments that are not made on account of a reasonable risk of liability for breach of a fiduciary duty under Title I of ERISA are not restorative payments and generally constitute



contributions that give rise to annual additions under paragraph (b)(4) of this section.

(D) *Excess deferrals.* Excess deferrals that are distributed in accordance with § 1.402(g)-1(e)(2) or (3) do not give rise to annual additions.

(3) *Employee contributions.* For purposes of paragraph (b)(1)(i)(B) of this section, the term *annual addition* includes mandatory employee contributions (as defined in section 411(c)(2)(C) and regulations promulgated under section 411) as well as voluntary employee contributions. The term *annual addition* does not include—

(i) Rollover contributions (as described in sections 401(a)(31), 402(c)(1), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16));

(ii) Repayments of loans made to a participant from the plan;

(iii) Repayments of amounts described in section 411(a)(7)(B) (in accordance with section 411(a)(7)(C)) and section 411(a)(3)(D) or repayment of contributions to a governmental plan (as defined in section 414(d)) as described in section 415(k)(3);

(iv) Repayments that would have been described in paragraph (b)(3)(iii) of this section except that the plan does not restrict the timing of repayments to the maximum extent permitted by section 411(a); or

(v) Employee contributions to a qualified cost of living arrangement within the meaning of section 415(k)(2)(B).

(4) *Transactions with plan.* The Commissioner may in an appropriate case, considering all of the facts and circumstances, treat transactions between the plan and the employer, transactions between the plan and the employee, or certain allocations to participants' accounts as giving rise to annual additions. Further, where an employee or employer transfers assets to a plan in exchange for consideration that is less than the fair market value of the assets transferred to the plan, there is an annual addition in the amount of the difference between the value of the assets transferred and the consideration. A transaction described in this paragraph (b)(4) may constitute a prohibited transaction with the meaning of section 4975(c)(1).

(5) *Contributions other than cash.* For purposes of this paragraph (b), a contribution by the employer or employee of property rather than cash is considered to be a contribution in an amount equal to the fair market value of the property on the date the contribution is made. For this purpose, the fair market value is the price at

which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. In addition, a contribution described in this paragraph (b)(5) may constitute a prohibited transaction within the meaning of section 4975(c)(1).

(6) *Timing rules—(i) In general—(A) Date of allocation.* For purposes of this paragraph (b), an annual addition is credited to the account of a participant for a particular limitation year if it is allocated to the participant's account under the terms of the plan as of any date within that limitation year. Similarly, an annual addition that is made pursuant to a corrective amendment that complies with the requirements of § 1.401(a)(4)-11(g) is credited to the account of a participant for a particular limitation year if it is allocated to the participant's account under the terms of the corrective amendment as of any date within that limitation year. However, if the allocation of an annual addition is dependent upon the satisfaction of a condition (such as continued employment or the occurrence of an event) that has not been satisfied by the date as of which the annual addition is allocated under the terms of the plan, then the annual addition is considered allocated for purposes of this paragraph (b) as of the date the condition is satisfied.

(B) *Date of employer contributions.* For purposes of this paragraph (b), employer contributions are not treated as credited to a participant's account for a particular limitation year unless the contributions are actually made to the plan no later than 30 days after the end of the period described in section 404(a)(6) applicable to the taxable year with or within which the particular limitation year ends. If, however, contributions are made by an employer exempt from Federal income tax (including a governmental employer), the contributions must be made to the plan no later than the 15th day of the tenth calendar month following the end of the calendar year or fiscal year (as applicable, depending on the basis on which the employer keeps its books) with or within which the particular limitation year ends. If contributions are made to a plan after the end of the period during which contributions can be made and treated as credited to a participant's account for a particular limitation year, allocations attributable to those contributions are treated as credited to the participant's account for

the limitation year during which those contributions are made.

(C) *Date of employee contributions.* For purposes of this paragraph (b), employee contributions, whether voluntary or mandatory, are not treated as credited to a participant's account for a particular limitation year unless the contributions are actually made to the plan no later than 30 days after the close of that limitation year.

(D) *Date for forfeitures.* A forfeiture is treated as an annual addition for the limitation year that contains the date as of which it is allocated to a participant's account as a forfeiture.

(E) *Treatment of elective contributions as plan assets.* The extent to which elective contributions constitute plan assets for purposes of the prohibited transaction provisions of section 4975 and Title I of ERISA, is determined in accordance with regulations and rulings issued by the Department of Labor. See 29 CFR 2510.3-102.

(ii) *Special timing rules—(A) Corrective contributions.* For purposes of this section, if, in a particular limitation year, an employer allocates an amount to a participant's account because of an erroneous forfeiture in a prior limitation year, or because of an erroneous failure to allocate amounts in a prior limitation year, the corrective allocation will not be considered an annual addition with respect to the participant for that particular limitation year, but will be considered an annual addition for the prior limitation year to which it relates. An example of a situation in which an employer contribution might occur under the circumstances described in the preceding sentence is a retroactive crediting of service for an employee under 29 CFR 2530.200b-2(a)(3) in accordance with an award of back pay. For purposes of this paragraph (b)(6)(ii), if the amount so contributed in the particular limitation year takes into account actual investment gains attributable to the period subsequent to the year to which the contribution relates, the portion of the total contribution that consists of such gains is not considered as an annual addition for any limitation year.

(B) *Contributions for accumulated funding deficiencies and previously waived contributions—(1) Accumulated funding deficiency.* In the case of a defined contribution plan to which the rules of section 412 apply, a contribution made to reduce an accumulated funding deficiency will be treated as if it were timely made for purposes of determining the limitation year in which the annual additions arising from the contribution are made,



but only if the contribution is allocated to those participants who would have received an annual addition if the contribution had been timely made.

(2) *Previously waived contributions.* In the case of a defined contribution plan to which the rules of section 412 apply and for which there has been a waiver of the minimum funding standard in a prior limitation year in accordance with section 412(d), that portion of an employer contribution in a subsequent limitation year which, if not for the waiver, would have otherwise been required in the prior limitation year under section 412(a) will be treated as if it were timely made (without regard to the funding waiver) for purposes of determining the limitation year in which the annual additions arising from the contribution are made, but only if the contribution is allocated to those participants who would have received an annual addition if the contribution had been timely made (without regard to the funding waiver).

(3) *Interest.* For purposes of determining the amount of the annual addition under paragraphs (b)(6)(ii)(B)(1) and (2) of this section, a reasonable amount of interest paid by the employer is disregarded. However, any interest paid by the employer that is in excess of a reasonable amount, as determined by the Commissioner, is taken into account as an annual addition for the limitation year during which the contribution is made.

(C) *Simplified employee pensions.* For purposes of this paragraph (b), amounts contributed to a simplified employee pension described in section 408(k) are treated as allocated to the individual's account as of the last day of the limitation year ending with or within the taxable year for which the contribution is made.

(D) *Treatment of certain contributions made pursuant to veterans' reemployment rights.* If, in a particular limitation year, an employer contributes an amount to an employee's account with respect to a prior limitation year and such contribution is required by reason of such employee's rights under chapter 43 of title 38, United States Code, resulting from qualified military service, as specified in section 414(u)(1), then such contribution is not considered an annual addition with respect to the employee for that particular limitation year in which the contribution is made, but, in accordance with section 414(u)(1)(B), is considered an annual addition for the limitation year to which the contribution relates.

(c) *Examples.* The following examples illustrate the rules of paragraphs (a) and (b) of this section:

*Example 1.* (i) P is a participant in a qualified profit-sharing plan maintained by his employer, ABC Corporation. The limitation year for the plan is the calendar year. P's compensation (as defined in § 1.415(c)-2) for the current limitation year is \$30,000.

(ii) Because the compensation limitation described in section 415(c)(1)(B) applicable to P for the current limitation year is lower than the dollar limitation described in section 415(c)(1)(A), the maximum annual addition which can be allocated to P's account for the current limitation year is \$30,000 (100 percent of \$30,000).

*Example 2.* (i) The facts are the same as in *Example 1*, except that P's compensation for the current limitation year is \$140,000.

(ii) The maximum amount of annual additions that may be allocated to P's account in the current limitation year is the lesser of \$140,000 (100 percent of P's compensation) or the dollar limitation of section 415(c)(1)(A) as in effect as of January 1 of the calendar year in which the current limitation year ends. If, for example, the dollar limitation of section 415(c)(1)(A) in effect as of January 1 of the calendar year in which the current limitation year ends is \$45,000, then the maximum annual addition that can be allocated to P's account for the current limitation year is \$45,000.

*Example 3.* (i) Employer N maintains a qualified profit-sharing plan that uses the calendar year as its plan year and its limitation year. N's taxable year is a fiscal year beginning June 1 and ending May 31. Under the terms of the profit-sharing plan maintained by N, employer contributions are made to the plan two months after the close of N's taxable year and are allocated as of the last day of the plan year ending within the taxable year (and are not dependent on the satisfaction of a condition). Thus, employer contributions for the 2008 calendar year limitation year are made on July 31, 2009 (the date that is two months after the close of N's taxable year ending May 31, 2009) and are allocated as of December 31, 2008.

(ii) Because the employer contributions are actually made to the plan no later than 30 days after the end of the period described in section 404(a)(6) with respect to N's taxable year ending May 31, 2009, the contributions will be considered annual additions for the 2008 calendar year limitation year.

*Example 4.* (i) The facts are the same as in *Example 3*, except that the plan year for the profit-sharing plan maintained by N is the 12-month period beginning on February 1 and ending on January 31. The limitation year continues to be the calendar year. Under the terms of the plan, an employer contribution which is made to the plan on July 31, 2009, is allocated to participants' accounts as of January 31, 2009.

(ii) Because the last day of the plan year is in the 2009 calendar year limitation year, and because, under the terms of the plan, employer contributions are allocated to participants' accounts as of the last day of the plan year, the contributions are considered

annual additions for the 2009 calendar year limitation year.

*Example 5.* (i) XYZ Corporation maintains a profit-sharing plan to which a participant may make voluntary employee contributions for any year not to exceed 10 percent of the participant's compensation for the year. The plan permits a participant to make retroactive make-up contributions for any year for which the participant contributed less than 10 percent of compensation. XYZ uses the calendar year as the plan year and the limitation year. Under the terms of the plan, voluntary employee contributions are credited to a participant's account for a particular limitation year if such contributions are allocated to the participant's account as of any date within that limitation year. Participant A's compensation is as follows—

Limitation year	Compensation
2008 .....	\$30,000
2009 .....	\$32,000
2010 .....	\$34,000
2011 .....	\$36,000

(ii) Participant A makes no voluntary employee contributions during limitation years 2008, 2009, and 2010. On October 1, 2011, participant A makes a voluntary employee contribution of \$13,200 (10 percent of A's aggregate compensation for limitation years 2008, 2009, 2010, and 2011 of \$132,000). Under the terms of the plan, \$3,000 of this 2011 contribution is allocated to A's account as of limitation year 2008; \$3,200 is allocated to A's account of limitation year 2009; \$3,400 is allocated to A's account as of limitation year 2010, and \$3,600 is allocated to A's account as of limitation year 2011.

(iii) Under the rule set forth in paragraph (b)(6)(i)(C) of this section, employee contributions will not be considered credited to a participant's account for a particular limitation year for section 415 purposes unless the contributions are actually made to the plan no later than 30 days after the close of that limitation year. Thus, A's voluntary employee contribution of \$13,200 made on October 1, 2011, would be considered as credited to A's account only for the 2011 calendar year limitation year, notwithstanding the plan provisions.

(d) *Special rules relating to church plans—(1) Alternative contribution limitation—(i) In general.* Pursuant to section 415(c)(7)(A), notwithstanding the general rule of paragraph (a)(1) of this section, additions for a section 403(b) annuity contract for a year with respect to a participant who is an employee of a church or a convention or association of churches, including an organization described in section 414(e)(3)(B)(ii), when expressed as an annual addition to such participant's account, are treated as not exceeding the limitation of paragraph (a)(1) of this section if such annual additions for the year are not in excess of \$10,000.

(ii) *\$40,000 aggregate limitation.* With respect to any participant, the total amount of annual additions that are in excess of the limitation of paragraph (a)(1) of this section but, pursuant to the rule of paragraph (d)(1)(i) of this section, are treated as not exceeding that limitation (taking into account the rule of paragraph (d)(3) of this section) cannot exceed \$40,000. Thus, the aggregate of annual additions for all limitation years that would exceed the limitation of this section but for this paragraph (d)(1) is limited to \$40,000.

(2) *Years of service taken into account for duly ordained, commissioned, or licensed ministers or lay employees.* For purposes of this paragraph (d)—

(i) All years of service by an individual as an employee of a church, or a convention or association of churches, including an organization described in section 414(e)(3)(B)(ii), are considered as years of service for one employer; and

(ii) All amounts contributed for annuity contracts by each such church (or convention or association of churches) during such years for the employee are considered to have been contributed by one employer.

(3) *Foreign missionaries.* Pursuant to section 415(c)(7)(C), in the case of any individual described in paragraph (d)(1) of this section performing any services for the church outside the United States during the limitation year, additions for an annuity contract under section 403(b) for any year are not treated as exceeding the limitation of paragraph (a)(1) of this section if such annual additions for the year do not exceed \$3,000. The preceding sentence shall not apply with respect to any taxable year to any individual whose adjusted gross income for such taxable year (determined separately and without regard to community property law) exceeds \$17,000.

(4) *Church, convention or association of churches.* For purposes of this paragraph (d), the terms “church” and “convention or association of churches” have the same meaning as when used in section 414(e).

(5) *Examples.* The following examples illustrate the rules of this paragraph (d):

*Example 1.* (i) E is an employee of ABC Church earning \$7,000 during each calendar year. E participates in a section 403(b) annuity contract maintained by ABC Church beginning in the year 2008. E's taxable year is the calendar year, and the limitation year for the plan coincides with the calendar year. ABC Church contributes \$10,000 to be allocated to E's account under the plan for the year 2008.

(ii) Under paragraph (d)(1) of this section, this allocation is treated as not violating the

limits established in paragraph (a)(1) of this section because it does not exceed \$10,000. Moreover, since an annual addition of \$10,000 would otherwise exceed the limitation of paragraph (a)(1) of this section by \$3,000, \$3,000 is counted toward the aggregate limitation specified in paragraph (d)(1)(ii) of this section for year 2008. Accordingly, ABC Church may make such allocations for 13 years (for example, for years 2008 through 2020) without exceeding the aggregate limitation of \$40,000 specified in paragraph (d) of this section. For the fourteenth year, ABC Church could allocate only \$8,000 to E's account (the sum of the \$7,000 limitation computed under paragraph (a)(1)(ii) of this section and the remaining \$1,000 of the \$40,000 aggregate limitation under paragraph (d)(1)(ii) of this section on annual additions in excess of the limits under paragraph (a)(1) of this section).

*Example 2.* (i) F is an employee of XYZ Church and F's taxable year is the calendar year. F earns \$2,000 during each calendar year for services he provides to XYZ Church, all of which are performed outside the United States during each calendar year. F participates in a section 403(b) annuity contract maintained by ABC Church beginning in the year 2008. The limitation year for the plan coincides with the calendar year. ABC Church contributes \$10,000 to be allocated to F's account under the plan for the year 2008. F's adjusted gross income for each taxable year (determined separately and without regard to community property law) does not exceed \$17,000.

(ii) Under paragraph (d)(1) of this section, this allocation is treated as not violating the limits established in paragraph (a)(1) of this section because it does not exceed \$10,000. Moreover, since an annual addition of \$10,000 would otherwise exceed the limitation of paragraph (a)(1) of this section by \$7,000 (the excess of \$10,000 over the greater of the \$2,000 compensation limitation under section 415(c)(1)(B) or the \$3,000 section 415(c)(7)(C) amount), XYZ Church may make such allocations for 5 years (for example, for years 2008 through 2012) without exceeding the aggregate limitation of \$40,000 specified in paragraph (d) of this section. In year 2013, XYZ church may contribute \$8,000 to be allocated to F's account under the plan (the sum of the \$3,000 limitation computed under paragraph (d)(3) of this section and the remaining \$5,000 of the \$40,000 aggregate limitation under paragraph (d)(1)(ii) of this section on annual additions in excess of the limits under paragraph (a)(1) of this section). For years after 2013, pursuant to paragraph (d)(3) of this section, XYZ Church could allocate \$3,000 per year to F's account.

(e) *Special rules for medical benefits.* The limit under paragraph (a)(1)(ii) of this section (100 percent of the participant's compensation for the limitation year) does not apply to—

(1) An individual medical benefit account (as defined in section 415(l)); or

(2) A post-retirement medical benefits account for a key employee (as defined in section 419A(d)(1)).

(f) *Special rules for employee stock ownership plans—*(1) *In general.* Special rules apply to employee stock ownership plans, as provided in paragraphs (f)(2) through (f)(4) of this section.

(2) *Determination of annual additions for leveraged employee stock ownership plans—*(i) *In general.* Except as provided in this paragraph (f) of this section, in the case of an employee stock ownership plan to which an exempt loan as described in § 54.4975-7(b) of this chapter has been made, the amount of employer contributions that is considered an annual addition for the limitation year is calculated with respect to employer contributions of both principal and interest used to repay that exempt loan for the limitation year.

(ii) *Employer stock that has decreased in value.* A plan may provide that, in lieu of computing annual additions in accordance with paragraph (f)(2)(i) of this section, annual additions with respect to a loan repayment described in paragraph (f)(2)(i) of this section are determined as the fair market value of shares released from the suspense account on account of the repayment and allocated to participants for the limitation year if that amount is less than the amount determined in accordance with paragraph (f)(2)(i) of this section.

(3) *Exclusions from annual additions for certain employee stock ownership plans that allocate to a broad range of participants—*(i) *General rule.* Pursuant to section 415(c)(6), in the case of an employee stock ownership plan (as described in section 4975(e)(7)) that meets the requirements of paragraph (f)(3)(ii) of this section for a limitation year, the limitations imposed by this section do not apply to—

(A) Forfeitures of employer securities (within the meaning of section 409(l)) under such an employee stock ownership plan if such securities were acquired with the proceeds of a loan (as described in section 404(a)(9)(A)); or

(B) Employer contributions to such an employee stock ownership plan which are deductible under section 404(a)(9)(B) and charged against the participant's account.

(ii) *Employee stock ownership plans to which the special exclusion applies.* An employee stock ownership plan meets the requirements of this paragraph (f)(3)(ii) for a limitation year if no more than one-third of the employer contributions for the limitation year that are deductible under section 404(a)(9) are allocated to highly compensated employees (within the meaning of section 414(q)).

(4) *Gratuitous transfers under section 664(g)(1)*. The amount of any qualified gratuitous transfer (as defined in section 664(g)(1)) allocated to a participant for any limitation year is not taken into account in determining whether any other annual addition exceeds the limitations imposed by this section, but only if the amount of the qualified gratuitous transfer does not exceed the limitations imposed by section 415.

■ **Par. 12.** Section 1.415(c)–2 is added to read as follows:

**§ 1.415(c)–2 Compensation.**

(a) *General definition.* Except as otherwise provided in this section, *compensation from the employer within the meaning of section 415(c)(3), which is used for purposes of section 415 and regulations promulgated under section 415*, means all items of remuneration described in paragraph (b) of this section, but excludes the items of remuneration described in paragraph (c) of this section. Paragraph (d) of this section provides safe harbor definitions of compensation that are permitted to be provided in a plan in lieu of the generally applicable definition of compensation. Paragraph (e) of this section provides timing rules relating to compensation. Paragraph (f) of this section provides rules regarding the application of the rules of section 401(a)(17) to the definition of compensation for purposes of section 415. Paragraph (g) of this section provides special rules relating to the determination of compensation, including rules for determining compensation for a section 403(b) annuity contract, rules for determining the compensation of employees of controlled groups or affiliated service groups, rules for disabled employees, rules relating to foreign compensation, rules regarding deemed section 125 compensation, rules for employees in qualified military service, and rules relating to back pay.

(b) *Items includible as compensation.* For purposes of applying the limitations of section 415, except as otherwise provided in this section, the term *compensation* means remuneration for services of the following types—

(1) The employee's wages, salaries, fees for professional services, and other amounts received (without regard to whether or not an amount is paid in cash) for personal services actually rendered in the course of employment with the employer maintaining the plan, to the extent that the amounts are includible in gross income (or to the extent amounts would have been received and includible in gross income

but for an election under section 125(a), 132(f)(4), 402(e)(3), 402(h)(1)(B), 402(k), or 457(b)). These amounts include, but are not limited to, commissions paid to salespersons, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, bonuses, fringe benefits, and reimbursements or other expense allowances under a nonaccountable plan as described in § 1.62–2(c).

(2) In the case of an employee who is an employee within the meaning of section 401(c)(1) and regulations promulgated under section 401(c)(1), the employee's earned income (as described in section 401(c)(2) and regulations promulgated under section 401(c)(2)), plus amounts deferred at the election of the employee that would be includible in gross income but for the rules of section 402(e)(3), 402(h)(1)(B), 402(k), or 457(b).

(3) Amounts described in section 104(a)(3), 105(a), or 105(h), but only to the extent that these amounts are includible in the gross income of the employee.

(4) Amounts paid or reimbursed by the employer for moving expenses incurred by an employee, but only to the extent that at the time of the payment it is reasonable to believe that these amounts are not deductible by the employee under section 217.

(5) The value of a nonstatutory option (which is an option other than a statutory option as defined in § 1.421–1(b)) granted to an employee by the employer, but only to the extent that the value of the option is includible in the gross income of the employee for the taxable year in which granted.

(6) The amount includible in the gross income of an employee upon making the election described in section 83(b).

(7) Amounts that are includible in the gross income of an employee under the rules of section 409A or section 457(f)(1)(A) or because the amounts are constructively received by the employee.

(c) *Items not includible as compensation.* The term *compensation* does not include—

(1) Contributions (other than elective contributions described in section 402(e)(3), section 408(k)(6), section 408(p)(2)(A)(i), or section 457(b)) made by the employer to a plan of deferred compensation (including a simplified employee pension described in section 408(k) or a simple retirement account described in section 408(p), and whether or not qualified) to the extent that the contributions are not includible in the gross income of the employee for the taxable year in which contributed. In addition, any distributions from a

plan of deferred compensation (whether or not qualified) are not considered as compensation for section 415 purposes, regardless of whether such amounts are includible in the gross income of the employee when distributed. However, if the plan so provides, any amounts received by an employee pursuant to a nonqualified unfunded deferred compensation plan are permitted to be considered as compensation for section 415 purposes in the year the amounts are actually received, but only to the extent such amounts are includible in the employee's gross income.

(2) Amounts realized from the exercise of a nonstatutory option (which is an option other than a statutory option as defined in § 1.421–1(b)), or when restricted stock or other property held by an employee either becomes freely transferable or is no longer subject to a substantial risk of forfeiture (see section 83 and regulations promulgated under section 83).

(3) Amounts realized from the sale, exchange, or other disposition of stock acquired under a statutory stock option (as defined in § 1.421–1(b)).

(4) Other amounts that receive special tax benefits, such as premiums for group-term life insurance (but only to the extent that the premiums are not includible in the gross income of the employee and are not salary reduction amounts that are described in section 125).

(5) Other items of remuneration that are similar to any of the items listed in paragraphs (c)(1) through (c)(4) of this section.

(d) *Safe harbor rules with respect to plan's definition of compensation*—(1) *In general.* Paragraphs (d)(2) through (4) of this section contain safe harbor definitions of compensation that are automatically considered to satisfy section 415(c)(3) if specified in the plan. The Commissioner may, in revenue rulings, notices, and other guidance of general applicability published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter), provide additional definitions of compensation that are treated as satisfying section 415(c)(3).

(2) *Simplified compensation.* The safe harbor definition of compensation under this paragraph (d)(2) includes only those items specified in paragraph (b)(1) or (2) of this section and excludes all those items listed in paragraph (c) of this section.

(3) *Section 3401(a) wages.* The safe harbor definition of compensation under this paragraph (d)(3) includes wages within the meaning of section 3401(a) (for purposes of income tax withholding at the source), plus

amounts that would be included in wages but for an election under section 125(a), 132(f)(4), 402(e)(3), 402(h)(1)(B), 402(k), or 457(b). However, any rules that limit the remuneration included in wages based on the nature or location of the employment or the services performed (such as the exception for agricultural labor in section 3401(a)(2)) are disregarded for this purpose.

(4) *Information required to be reported under sections 6041, 6051 and 6052.* The safe harbor definition of compensation under this paragraph (d)(4) includes amounts that are compensation under the safe harbor definition of paragraph (d)(3) of this section, plus all other payments of compensation to an employee by his employer (in the course of the employer's trade or business) for which the employer is required to furnish the employee a written statement under sections 6041(d), 6051(a)(3), and 6052. See §§ 1.6041-1(a), 1.6041-2(a)(1), 1.6052-1, and 1.6052-2, and also see § 1.6051-1(a)(1)(i)(C) of this chapter. This safe harbor definition of compensation may be modified to exclude amounts paid or reimbursed by the employer for moving expenses incurred by an employee, but only to the extent that, at the time of the payment, it is reasonable to believe that these amounts are deductible by the employee under section 217.

(e) *Timing rules—(1) In general—(i) Payment during the limitation year.* Except as otherwise provided in this paragraph (e), in order to be taken into account for a limitation year, compensation within the meaning of section 415(c)(3) must be actually paid or made available to an employee (or, if earlier, includible in the gross income of the employee) within the limitation year. For this purpose, compensation is treated as paid on a date if it is actually paid on that date or it would have been paid on that date but for an election under section 125, 132(f)(4), 401(k), 403(b), 408(k), 408(p)(2)(A)(i), or 457(b).

(ii) *Payment prior to severance from employment.* Except as otherwise provided in this paragraph (e), in order to be taken into account for a limitation year, compensation within the meaning of section 415(c)(3) must be paid or treated as paid to the employee (in accordance with the rules of paragraph (e)(1)(i) of this section) prior to the employee's severance from employment with the employer maintaining the plan. See § 1.415(a)-1(f)(5) for the definition of severance from employment.

(2) *Certain minor timing differences.* Notwithstanding the provisions of paragraph (e)(1)(i) of this section, a plan may provide that compensation for a

limitation year includes amounts earned during that limitation year but not paid during that limitation year solely because of the timing of pay periods and pay dates if—

(i) These amounts are paid during the first few weeks of the next limitation year;

(ii) The amounts are included on a uniform and consistent basis with respect to all similarly situated employees; and

(iii) No compensation is included in more than one limitation year.

(3) *Compensation paid after severance from employment—(i) In general.* Any compensation described in paragraph (e)(3)(ii) of this section does not fail to be compensation (within the meaning of section 415(c)(3)) pursuant to the rule of paragraph (e)(1)(ii) of this section merely because it is paid after the employee's severance from employment with the employer maintaining the plan, provided the compensation is paid by the later of 2½ months after severance from employment with the employer maintaining the plan or the end of the limitation year that includes the date of severance from employment with the employer maintaining the plan. In addition, the plan may provide that amounts described in paragraph (e)(3)(iii) of this section are included in compensation (within the meaning of section 415(c)(3)) if—

(A) Those amounts are paid by the later of 2½ months after severance from employment with the employer maintaining the plan or the end of the limitation year that includes the date of severance from employment with the employer maintaining the plan; and

(B) Those amounts would have been included in the definition of compensation if they were paid prior to the employee's severance from employment with the employer maintaining the plan.

(ii) *Regular pay after severance from employment.* An amount is described in this paragraph (e)(3)(ii) if—

(A) The payment is regular compensation for services during the employee's regular working hours, or compensation for services outside the employee's regular working hours (such as overtime or shift differential), commissions, bonuses, or other similar payments; and

(B) The payment would have been paid to the employee prior to a severance from employment if the employee had continued in employment with the employer.

(iii) *Leave cashouts and deferred compensation.* An amount is described

in this paragraph (e)(3)(iii) if the amount is either—

(A) Payment for unused accrued bona fide sick, vacation, or other leave, but only if the employee would have been able to use the leave if employment had continued; or

(B) Received by an employee pursuant to a nonqualified unfunded deferred compensation plan, but only if the payment would have been paid to the employee at the same time if the employee had continued in employment with the employer and only to the extent that the payment is includible in the employee's gross income.

(iv) *Other post-severance payments.* Any payment that is not described in paragraph (e)(3)(ii) or (iii) of this section is not considered compensation under paragraph (e)(3)(i) of this section if paid after severance from employment with the employer maintaining the plan, even if it is paid within the time period described in paragraph (e)(3)(i) of this section. Thus, compensation does not include severance pay, or parachute payments within the meaning of section 280G(b)(2), if they are paid after severance from employment with the employer maintaining the plan, and does not include post-severance payments under a nonqualified unfunded deferred compensation plan unless the payments would have been paid at that time without regard to the severance from employment.

(4) *Salary continuation payments for military service and disabled participants.* The rule of paragraph (e)(1)(ii) of this section does not apply to payments to an individual who does not currently perform services for the employer by reason of qualified military service (as that term is used in section 414(u)(1)) to the extent those payments do not exceed the amounts the individual would have received if the individual had continued to perform services for the employer rather than entering qualified military service, but only if the plan so provides. In addition, the rule of paragraph (e)(1)(ii) of this section does not apply to compensation paid to a participant who is permanently and totally disabled (as defined in section 22(e)(3)) if the conditions set forth in paragraph (g)(4)(ii)(A) of this section are satisfied (applied by substituting a continuation of compensation for the continuation of contributions), but only if the plan so provides.

(5) *Special rule for governmental plans.* For purposes of applying the rules of paragraph (e)(3) of this section, a governmental plan (as defined in section 414(d)) may provide for the substitution of the calendar year in

which the severance from employment with the employer maintaining the plan occurs for the limitation year in which the severance from employment with the employer maintaining the plan occurs.

(6) *Examples.* The provisions of this paragraph (e) are illustrated by the following examples:

*Example 1.* (i) *Facts.* Participant A was a common law employee of Employer X, performing services as a script writer for Employer X from January 1, 2005 to December 31, 2005. Pursuant to a collective bargaining agreement, Employer X, Employer Y and Employer Z maintain and contribute to Plan T, a multiemployer plan (as defined in section 414(f)) in which Participant A participates. Under the collective bargaining agreement, Participant A is entitled to residual payments whenever television shows that Participant A wrote are re-used commercially (These residual payments constitute compensation described in paragraph (b) of this section and do not constitute compensation described in paragraph (c) of this section.). In the year 2008, Participant A receives residual payments from Employer X for television programs using the scripts that Participant A wrote in the year 2005 that were rebroadcast in the year 2008. In the years 2006, 2007, and 2008, Participant A was a common law employee of Employer Y, and did not perform any services for Employer X.

(ii) *Conclusion.* The residual payments received from Employer X by Participant A in the year 2008 are compensation for purposes of section 415(c)(3). The payments are not treated as made after severance from employment because Plan T is a multiemployer plan (as defined in section 414(f)) and Participant A continues to be employed by an employer maintaining Plan T.

*Example 2.* (i) *Facts.* The facts are the same as in *Example 1*, except that Participant A: ceased employment with Employer Y in the year 2006; subsequently moved away from the area in which A formerly worked; performs no services as an employee for any employer; and commenced receiving distributions under Plan T in March, 2006.

(ii) *Conclusion.* Based on the facts and circumstances, A has ceased employment with any employer maintaining Plan T. Pursuant to paragraph (e)(1)(ii) of this section, compensation must be paid prior to an employee's severance from employment with the employer maintaining the plan. Accordingly, the residual payments received by Participant A in the year 2008 are not compensation for purposes of section 415(c)(3).

(f) *Interaction with section 401(a)(17).* Because a plan may not base allocations (in the case of a defined contribution plan) or benefits (in the case of a defined benefit plan) on compensation in excess of the limitation under section 401(a)(17), a plan's definition of compensation for a year that is used for purposes of applying the limitations of

section 415 is not permitted to reflect compensation for a year that is in excess of the limitation under section 401(a)(17) that applies to that year. See §§ 1.401(a)(17)–1(a)(3)(i) and 1.401(a)(17)–1(b)(3)(ii) for rules regarding the effective date of increases in the section 401(a)(17) compensation limitation for a plan year and for a 12-month period other than the plan year.

(g) *Special rules—(1) Compensation for section 403(b) annuity contract.* In the case of an annuity contract described in section 403(b), the term *participant's compensation* means the participant's includible compensation determined under section 403(b)(3). Accordingly, the rules for determining a participant's compensation pursuant to section 415(c)(3) (other than section 415(c)(3)(E)) and this section do not apply to a section 403(b) annuity contract.

(2) *Employees of controlled groups of corporations, etc.* In the case of an employee of two or more corporations which are members of a controlled group of corporations (as defined in section 414(b) as modified by section 415(h)), the term *compensation* for such employee includes compensation from all employers that are members of the group, regardless of whether the employee's particular employer has a qualified plan. This special rule is also applicable to an employee of two or more trades or businesses (whether or not incorporated) that are under common control (as defined in section 414(c) as modified by section 415(h)), to an employee of two or more members of an affiliated service group as defined in section 414(m), and to an employee of two or more members of any group of employers who must be aggregated and treated as one employer pursuant to section 414(o).

(3) *Aggregation of section 403(b) annuity with qualified plan of controlled employer.* If a section 403(b) annuity contract is aggregated with a qualified plan of a controlled employer in accordance with § 1.415(f)–1(f)(2), then, in applying the limitations of section 415(c) in connection with the aggregation of the section 403(b) annuity with a qualified plan, the total compensation from both employers is permitted to be taken into account.

(4) *Permanent and total disability of defined contribution plan participant—*(i) *In general.* Pursuant to section 415(c)(3)(C), if the conditions set forth in paragraph (g)(4)(ii) of this section are satisfied, then, in the case of a participant in any defined contribution plan who is permanently and totally disabled (as defined in section 22(e)(3)), the *participant's compensation* means

the compensation the participant would have received for the year if the participant was paid at the rate of compensation paid immediately before becoming permanently and totally disabled, if such compensation is greater than the participant's compensation determined without regard to this paragraph (g)(4).

(ii) *Conditions for deemed disability compensation.* The rule of paragraph (g)(4)(i) of this section applies only if the following conditions are satisfied—

(A) Either the participant is not a highly compensated employee (as defined in section 414(q)) immediately before becoming disabled, or the plan provides for the continuation of contributions on behalf of all participants who are permanently and totally disabled for a fixed or determinable period;

(B) The plan provides that the rule of this paragraph (g)(4) (treating certain amounts as compensation for a disabled participant) applies with respect to the participant; and

(C) Contributions made with respect to amounts treated as compensation under this paragraph (g)(4) are nonforfeitable when made.

(5) *Foreign compensation, etc.—*(i) *In general.* Amounts paid to an individual as compensation for services do not fail to be treated as compensation under paragraphs (b)(1) and (2) of this section (and are not excluded from the definition of compensation pursuant to paragraph (c)(4) of this section) merely because those amounts are not includible in the individual's gross income on account of the location of the services. Similarly, compensation for services do not fail to be treated as compensation under paragraphs (b)(1) and (2) of this section (and are not excluded from the definition of compensation pursuant to paragraph (c)(4) of this section) merely because those amounts are paid by an employer with respect to which all compensation paid to the participant by such employer is excluded from gross income. Thus, for example, the determination of whether an amount is treated as compensation under paragraph (b)(1) or (2) of this section is made without regard to the exclusions from gross income under sections 872, 893, 894, 911, 931, and 933.

(ii) *Exclusion of non-participant compensation by the plan.* With respect to a nonresident alien who is not a participant in a plan, the plan may provide that the compensation described in paragraph (g)(5)(i) of this section is not treated as compensation for purposes of paragraphs (b)(1) and (b)(2) of this section to the extent the

compensation is excludable from gross income and is not effectively connected with the conduct of a trade or business within the United States, but only if the plan applies this rule uniformly to all such employees. For purposes of this paragraph (g)(5)(ii), nonresident alien has the same meaning as in section 7701(b)(1)(B).

(6) *Deemed section 125 compensation*—(i) *General rule.* A plan is permitted to provide that deemed section 125 compensation (as defined in paragraph (g)(6)(ii) of this section) is compensation within the meaning of section 415(c)(3), but only if the plan applies this rule uniformly to all employees with respect to whom amounts subject to section 125 are included in compensation.

(ii) *Definition of deemed section 125 compensation.* Deemed section 125 compensation is an amount that is excludable from the income of the participant under section 106 that is not available to the participant in cash in lieu of group health coverage under a section 125 arrangement solely because that participant is not able to certify that the participant has other health coverage. Under this definition, amounts are deemed section 125 compensation only if the employer does not otherwise request or collect information regarding the participant's other health coverage as part of the enrollment process for the health plan.

(7) *Employees in qualified military service.* See section 414(u)(7) for special rules regarding compensation of employees who are in qualified military service within the meaning of section 414(u)(5).

(8) *Back pay.* Payments awarded by an administrative agency or court or pursuant to a bona fide agreement by an employer to compensate an employee for lost wages are compensation within the meaning of section 415(c)(3) for the limitation year to which the back pay relates, but only to the extent such payments represent wages and compensation that would otherwise be included in compensation under this section.

**Par. 13.** Section 1.415(d)–1 is added to read as follows:

**§ 1.415(d)–1 Cost of living adjustments.**

(a) *Defined benefit plans*—(1) *Dollar limitation*—(i) *Determination of adjusted limit.* Under section 415(d)(1)(A), the dollar limitation described in section 415(b)(1)(A) applicable to defined benefit plans is adjusted annually to take into account increases in the cost of living. The adjustment of the dollar limitation is

made by multiplying the adjustment factor for the year, as described in paragraph (a)(1)(ii)(A) of this section, by \$160,000, and rounding the result in accordance with paragraph (a)(1)(iii) of this section. The adjusted dollar limitation is prescribed by the Commissioner and published in the Internal Revenue Bulletin. See § 601.601(d)(2) of this chapter.

(ii) *Determination of adjustment factor*—(A) *Adjustment factor.* The adjustment factor for a calendar year is equal to a fraction, the numerator of which is the value of the applicable index for the calendar quarter ending September 30 of the preceding calendar year, and the denominator of which is the value of such index for the base period. The applicable index is determined consistent with the procedures used to adjust benefit amounts under section 215(i)(2)(A) of the Social Security Act, Public Law 92–336 (86 Stat. 406), as amended. If, however, the value of that fraction is less than one for a calendar year, then the adjustment factor for the calendar year is equal to one.

(B) *Base period.* For the purpose of adjusting the dollar limitation pursuant to paragraph (a)(1)(ii)(A) of this section, the base period is the calendar quarter beginning July 1, 2001.

(iii) *Rounding.* Any increase in the \$160,000 amount specified in section 415(b)(1)(A) which is not a multiple of \$5,000 is rounded to the next lowest multiple of \$5,000.

(2) *Average compensation for high-3 years of service limitation*—(i) *Determination of adjusted limit.* Under section 415(d)(1)(B), with regard to participants who have had a severance from employment with the employer maintaining the plan, the compensation limitation described in section 415(b)(1)(B) is permitted to be adjusted annually to take into account increases in the cost of living. For any limitation year beginning after the severance occurs, the adjustment of the compensation limitation is made by multiplying the annual adjustment factor (as defined in paragraph (a)(2)(ii) of this section) by the compensation limitation applicable to the participant in the prior limitation year. The annual adjustment factor is prescribed by the Commissioner and published in the Internal Revenue Bulletin. See § 601.601(d)(2) of this chapter.

(ii) *Annual adjustment factor.* The annual adjustment factor for a calendar year is equal to a fraction, the numerator of which is the value of the applicable index for the calendar quarter ending September 30 of the preceding calendar year, and the denominator of which is

the value of such index for the calendar quarter ending September 30 of the calendar year prior to that preceding calendar year. The applicable index is determined consistent with the procedures used to adjust benefit amounts under section 215(i)(2)(A) of the Social Security Act. If the value of the fraction described in the first sentence of this paragraph (a)(2)(ii) is less than one for a calendar year, then the adjustment factor for the calendar year is equal to one. In such a case, the annual adjustment factor for future calendar years will be determined in accordance with revenue rulings, notices, or other published guidance prescribed by the Commissioner and published in the Internal Revenue Bulletin. See § 601.601(d)(2) of this chapter.

(iii) *Special rule for rehired employees.* If, after having a severance from employment with the employer maintaining the plan, an employee is rehired by the employer maintaining the plan, the employee's compensation limit under section 415(b)(1)(B) is the greater of—

(A) 100 percent of the participant's average compensation for the period of the participant's high-3 years of service, as determined prior to the employee's severance from employment with the employer maintaining the plan, as adjusted pursuant to paragraph (a)(2)(i) of this section (if the plan so provides); or

(B) 100 percent of the participant's average compensation for the period of the participant's high-3 years of service, with the period of the participant's high-3 years of service determined pursuant to § 1.415(b)–1(a)(5)(iii).

(3) *Effective date of adjustment.* The adjusted dollar limitation applicable to defined benefit plans and the adjusted compensation limit applicable to a participant are effective as of January 1 of each calendar year and apply with respect to limitation years ending with or within that calendar year. However, benefit payments (and, in the case of plans that are subject to the requirements of section 411, accrued benefits for a limitation year) cannot exceed the currently applicable dollar limitation or compensation limitation (as in effect before the January 1 adjustment) prior to January 1. Thus, where there is an increase in the limitation under section 415(b)(1), any increase in a participant's benefits associated with the limitation increase is permitted to occur as of a date no earlier than January 1 of the calendar year for which the increase in the limitation is effective, and can only be applied for payments due on or after



January 1 of such calendar year. For example, assume that a participant in a defined benefit plan is currently receiving a benefit in the form of a straight life annuity, payable monthly, in an amount equal to the section 415(b)(1)(A) dollar limit, and the defined benefit plan has a limitation year that runs from July 1 to June 30. If the plan is amended to reflect the section 415(d) increase to the section 415(b)(1)(A) dollar limit that is effective as of January 1, 2009, the associated increase in the participant's monthly benefit payments is only effective for payments due on or after January 1, 2009, and the participant's benefit cannot be increased to reflect the section 415(d) increase that is effective January 1, 2009, with respect to any monthly payment due prior to January 1, 2009.

(4) *Application of adjusted figure*—(i) *In general.* If the dollar limitation of section 415(b)(1)(A) or the compensation limitation of section 415(b)(1)(B) is adjusted pursuant to section 415(d) for a limitation year, the adjustment is applied as provided in this paragraph (a)(4).

(ii) *Application of adjusted limitations to benefits that have not commenced.* An adjustment to the dollar limitation of section 415(b)(1)(A) is permitted to be applied to a participant who has not commenced benefits before the date on which the adjustment is effective. Annual adjustments to the compensation limit of section 415(b)(1)(B) as described in paragraph (a)(2) of this section are permitted to be made for all limitation years that begin after the participant's severance from employment, and apply to distributions that commence after the effective dates of such adjustments. However, no adjustment to the compensation limit of section 415(b)(1)(B) is made for any limitation year that begins on or before the date of the participant's severance from employment with the employer maintaining the plan.

(iii) *Application of adjusted dollar limitation to remaining payments under benefits that have commenced.* With respect to a distribution of accrued benefits that commenced before the date on which an adjustment to the section 415(b)(1)(A) dollar limitation is effective, a plan is permitted to apply the adjusted limitations to that distribution, but only to the extent that benefits have not been paid. Thus, for example, a plan cannot provide that the adjusted dollar limitation applies to a participant who has previously received the entire plan benefit in a single-sum distribution. However, a plan can

provide for an increase in benefits to a participant who accrues additional benefits under the plan that could have been accrued without regard to the adjustment of the dollar limitation (including benefits that accrue as a result of a plan amendment) on or after the effective date of the adjusted limitation.

(iv) *Manner of adjustment for benefits that have commenced.* If a plan is amended to increase benefits payable under the plan in accordance with paragraphs (a)(5) or (a)(6) of this section (or the plan is treated as applying paragraph (a)(5) of this section because the plan incorporates the section 415(d) cost-of-living adjustments automatically by reference pursuant to § 1.415(a)–1(d)(3)(v)), or if benefits payable under the plan are increased pursuant to a form of benefit that is described in § 1.415(b)–1(c)(5), then the distribution as increased will be treated as continuing to satisfy the requirements of section 415(b). If benefits payable under a plan are increased in a manner other than as described in the preceding sentence, the plan must satisfy the requirements of § 1.415(b)–1(b)(1)(iii), treating the commencement of the additional benefit as the commencement of a new distribution that gives rise to a new annuity starting date.

(5) *Safe harbor for annual adjustments to distributions.* An amendment to a plan to incorporate adjustments to the section 415(b) limits that increases a distribution that has previously commenced is described in this paragraph (a)(5) if—

(i) The employee has received one or more distributions that satisfy the requirements of section 415(b) before the date the adjustment to the applicable limits is effective (as determined under paragraph (a)(3) of this section);

(ii) The increased distribution is solely as a result of the amendment of the plan to reflect the adjustment to the applicable limits pursuant to section 415(d); and

(iii) The amounts payable to the employee on and after the effective date of the adjustment (as determined under paragraph (a)(3) of this section) are not greater than the amounts that would otherwise be payable without regard to the adjustment, multiplied by a fraction determined for the limitation year, the numerator of which is the limitation under section 415(b) (which is the lesser of the applicable dollar limitation under section 415(b)(1)(A), as adjusted for age at commencement, and the applicable compensation-based limitation under section 415(b)(1)(B)) in effect with respect to the distribution taking into

account the section 415(d) adjustment, and the denominator of which is the limitation under section 415(b) in effect for the distribution immediately before the adjustment.

(6) *Safe harbor for periodic adjustments to distributions*—(i) *General rule.* An amendment to a plan that increases a distribution that has previously commenced is made using the safe harbor methodology of this paragraph (a)(6) if—

(A) The employee has received one or more distributions that satisfy the requirements of section 415(b) before the date on which the increase is effective; and

(B) The amounts payable to the employee on and after the effective date of the increase are not greater than the amounts that would otherwise be payable without regard to the increase, multiplied by the cumulative adjustment fraction.

(ii) *Cumulative adjustment fraction.* The cumulative adjustment fraction for purposes of this paragraph (a)(6) is equal to the product of all of the fractions described in paragraph (a)(5)(iii) of this section that would have applied after benefits commence if the plan had been amended each year to incorporate the section 415(d) adjustments to the applicable section 415(b) limits and had otherwise satisfied the safe harbor methodology described in paragraph (a)(5) of this section. For purposes of the preceding sentence, if for the limitation year for which the increase to the section 415(b)(1)(A) dollar limitation pursuant to section 611(a)(1)(A) of the Economic Growth and Tax Relief Reconciliation Act of 2001 (115 Stat. 38), Public Law 107–16 (EGTRRA), is first effective (generally, the first limitation year beginning after December 31, 2001), the section 415(b)(1)(A) dollar limit applicable to a participant is less than the section 415(b)(1)(B) compensation limit for the participant, then the fraction described in paragraph (a)(5)(iii) of this section for that limitation year is 1.0.

(7) *Examples.* The following examples illustrate the application of this paragraph (a):

*Example 1.* (i) X is a participant in a qualified defined benefit plan maintained by X's employer. The plan has a calendar year limitation year. Under the terms of the plan, X is entitled to a benefit consisting of a straight life annuity equal to 100 percent of X's average compensation for the period of X's high-3 years of service. X's average compensation for the period of X's high-3 years of service is \$50,000. X incurs a severance from employment with the employer maintaining the plan on October 3,



2007, at age 65 with a nonforfeitable right to the accrued benefit after more than 10 years of participation in the plan. X begins to receive annual benefit payments (payable monthly) of \$50,000, commencing on November 1, 2007. The dollar limitation for the 2007 limitation year (as adjusted pursuant to section 415(d)) is \$180,000. Assume that the dollar limitation for the 2008 limitation year (as adjusted pursuant to section 415(d)) is \$185,000 and the annual adjustment factor for adjusting the compensation limitation of section 415(b)(1)(B) for the 2008 limitation year is 1.0334. Effective January 1, 2008, the plan is amended to incorporate these adjustments to the dollar and compensation limitations, and accordingly, X's annual benefit payment is increased, effective for payments due on or after January 1, 2008. Prior to the plan amendment incorporating the application of the adjusted dollar and compensation limitations, X has received one or more distributions that satisfy the requirements of section 415(b). In addition, the adjustment to X's annual benefit payments is solely on account of the plan amendment incorporating the adjusted limitations.

(ii) For the limitation year beginning January 1, 2008, the dollar limit applicable to X under section 415(b)(1)(A) is \$185,000, and the compensation limit applicable to X under section 415(b)(1)(B) is \$51,670 (\$50,000 multiplied by the annual adjustment factor of 1.0334). Accordingly, the adjustment to X's benefit satisfies the safe harbor for cost-of-living adjustments under paragraph (a)(5) of this section if, after the adjustment, X's benefit payable in the 2008 limitation year is no greater than \$50,000 multiplied by \$51,670 (X's section 415(b) limitation for 2008)/\$50,000 (X's section 415(b) limitation for 2007).

*Example 2.* (i) The facts are the same as in *Example 1*, except that X's average compensation for the period of X's high-3 consecutive years of service is \$200,000. Consequently, X's annual benefit payments commencing on November 1, 2007, are limited to \$180,000.

(ii) For the limitation year beginning January 1, 2008, the dollar limit applicable to X under section 415(b)(1)(A) is \$185,000, and the compensation limit applicable to X under section 415(b)(1)(B) is \$206,680 (\$200,000 multiplied by the annual adjustment factor of 1.0334). Accordingly, the adjustment to X's benefit satisfies the safe harbor for cost-of-living adjustments under paragraph (a)(5) of this section if, after the adjustment, X's benefit payable in 2008 is no greater than \$180,000 multiplied by \$185,000 (X's section 415(b) limitation for 2008)/\$180,000 (X's section 415(b) limitation for 2007).

*Example 3.* (i) X is a participant in Plan T, a qualified defined benefit plan maintained by X's employer. In the year 2008, X receives a single-sum distribution of X's entire accrued benefit under the plan. At the time that X receives the single-sum distribution, X's accrued benefit under Plan T is limited by the section 415(b)(1)(A) age-adjusted dollar limit. X accrues no further benefits under Plan T after X receives the single-sum distribution. In the 2009 limitation year, pursuant to section 415(d) and § 1.415(d)-1,

the section 415(b)(1)(A) dollar limit is increased.

(ii) In the 2009 limitation year, Plan T may not provide additional benefits to X on account of the increase in the section 415(b)(1)(A) dollar limit pursuant to section 415(d) and § 1.415(d)-1.

*Example 4.* (i) X is a participant in Plan T, a qualified defined benefit plan maintained by X's employer, Employer S. Plan T has a calendar limitation year. In 2008, X incurs a severance from employment with Employer S and X commences receiving distributions from Plan T in the form of a single life annuity in an annual amount of \$30,000. At the time that X commences receiving distributions from Plan T, X's accrued benefit under Plan T is limited by the section 415(b)(1)(B) compensation limit. In 2009, the annual adjustment factor described in paragraph (a)(2) of this section (which is the factor for adjusting the compensation limit described in section 415(b)(1)(B)) is 1.03. Employer S amends Plan T, effective as of January 1, 2009, to increase the annual benefit of all participants who, prior to January 1, 2009, incurred a severance from employment with Employer S and who have commenced receiving benefits from Plan T by a factor of 1.015. Assume that for limitation years prior to 2009, X's distributions from Plan T satisfy the requirements of section 415(b).

(ii) The increase in X's annual benefit pursuant to the amendment effective January 1, 2009, is within the safe harbor described in paragraph (a)(6) of this section. This is because the amount payable to X under Plan T for the 2009 limitation year and limitation years thereafter (as increased by the amendment effective January 1, 2009) is not greater than the product of the amount payable to X under Plan T for such limitation years (as determined without regard to the amendment increasing X's benefit effective January 1, 2009) and the cumulative adjustment fraction (which, in X's case, is 1.03). Thus, X's annual benefit, as increased by the amendment, is not determined pursuant to the rules of § 1.415(b)-1(b)(1)(iii).

*Example 5.* (i) Participant P participated in Plan A, maintained by Employer M, for more than 10 years. Plan A uses a calendar year limitation year and Plan A automatically adjusts a participant's section 415(b)(1)(B) compensation limit for limitation years after the limitation year in which the participant incurs a severance from employment as described in § 1.415(a)-1(d)(3)(v). Prior to separating from employment with M in 2010, P's average compensation for P's period of high-3 years while a participant in Plan A is \$50,000, based on P's compensation for 2007, 2008, and 2009, which was \$50,000 for each year. P's compensation for year 2010 was \$45,000. In year 2012, P is rehired by M and resumes participation in Plan A. P's compensation in year 2012 is \$45,000, and is \$70,000 in year 2013. Assume that the annual adjustment factor described in § 1.415(d)-1(a)(2)(ii) for the limitation years 2011 through 2013 is 1.03 for each year. Thus, disregarding P's rehire by M, P's average compensation for P's period of high-3 years while a participant in Plan A for the 2013 limitation year would be equal to \$54,636 (or

$1.03 * 1.03 * 1.03 * \$50,000$ ). See § 1.415(b)-1(a)(5)(iii).

(ii) Under § 1.415(d)-1(a)(2)(iii), P's average compensation for P's period of high-3 years while a participant in Plan A for the 2013 limitation year is \$54,636.

(b) *Defined contribution plans*—(1) *In general.* Under section 415(d)(1)(C), the dollar limitation described in section 415(c)(1)(A) is adjusted annually to take into account increases in the cost of living. The adjusted dollar limitation is prescribed by the Commissioner and published in the Internal Revenue Bulletin. See § 601.601(d)(2) of this chapter.

(2) *Determination of adjusted limit*—(i) *Base period.* The base period taken into account for purposes of adjusting the dollar limitation pursuant to paragraph (b)(2)(ii) of this section is the calendar quarter beginning July 1, 2001.

(ii) *Method of adjustment*—(A) *In general.* The dollar limitation is adjusted with respect to a calendar year based on the increase in the applicable index for the calendar quarter ending September 30 of the preceding calendar year over such index for the base period. Adjustment procedures similar to the procedures used to adjust benefit amounts under section 215(i)(2)(A) of the Social Security Act will be used.

(B) *Rounding.* Any increase in the \$40,000 amount specified in section 415(c)(1)(A) which is not a multiple of \$1,000 shall be rounded to the next lowest multiple of \$1,000.

(iii) *Effective date of adjustment.* The adjusted dollar limitation applicable to defined contribution plans is effective as of January 1 of each calendar year and applies with respect to limitation years ending with or within that calendar year. Annual additions for a limitation year cannot exceed the currently applicable dollar limitation (as in effect before the January 1 adjustment) prior to January 1. However, after a January 1 adjustment is made, annual additions for the entire limitation year are permitted to reflect the dollar limitation as adjusted on January 1.

(c) *Application of rounding rules to other cost-of-living adjustments.* Pursuant to section 415(d)(4)(A), the \$5,000 rounding methodology of paragraph (a)(1)(iii) of this section is used for purposes of any provision of chapter 1 of subtitle A of the Internal Revenue Code that provides for adjustments in accordance with section 415(d), except to the extent provided by that provision. Thus, the \$5,000 rounding methodology of paragraph (a)(1)(iii) of this section is used for purposes of—

(1) Determining the level of compensation specified in section 414(q)(1)(B) that is used to determine whether an employee is a highly compensated employee;

(2) Calculating the amounts used pursuant to section 409(o)(1)(C) to determine the maximum period over which distributions from an employee stock ownership plan may be made without participant consent; and

(3) Determining the levels of compensation specified in § 1.61-21(f)(5)(i) and (iii) used in determining whether an employee is a control employee of a nongovernmental employer for purposes of the commuting valuation rule of § 1.61-21(f).

(d) *Implementation of cost-of-living adjustments.* A plan is permitted to be amended to reflect any of the adjustments described in this section at any time after those limitations become applicable. Alternatively, a plan is permitted to incorporate by reference any of the adjustments described in this section in accordance with the rules of § 1.415(a)–1(d)(3)(v). Because the accrued benefit of a participant can reflect increases in the applicable limitations only after those increases become effective, a pattern of repeated plan amendments increasing annual benefits to reflect the increases in the section 415(b) limitations pursuant to section 415(d) does not result in any protection under section 411(d)(6) for future increases to reflect increases in the section 415(b) limitations pursuant to § 1.411(d)–4, Q&A–1(c)(1). Thus, a plan does not violate the requirements of section 411(d)(6) merely because the plan has been amended annually for a number of years to increase annual benefits to reflect the increases in the section 415(b) limitations pursuant to section 415(d) and subsequently is not amended to reflect later increases in the section 415(b) limitations.

**Par. 14.** Section 1.415(f)–1 is added to read as follows:

**§ 1.415(f)–1 Aggregating plans.**

(a) *In general.* Except as provided in paragraph (g) of this section (regarding multiemployer plans), and taking into account the rules of paragraph (b)(2) (regarding the break-up of affiliated employers and affiliated service groups), paragraph (c) (regarding predecessor employers), and paragraph (d)(1) (regarding nonduplication rules) of this section, section 415(f) and this section require that for purposes of applying the limitations of sections 415(b) and (c) applicable to a participant for a particular limitation year—

(1) All defined benefit plans (without regard to whether a plan has been terminated) ever maintained by the employer (or a predecessor employer within the meaning of paragraphs (c)(1) and (c)(2) of this section) under which the participant has accrued a benefit are treated as one defined benefit plan;

(2) All defined contribution plans (without regard to whether a plan has been terminated) ever maintained by the employer (or a predecessor employer within the meaning of paragraphs (c)(1) and (c)(2) of this section) under which the participant receives annual additions are treated as one defined contribution plan; and

(3) All section 403(b) annuity contracts purchased by an employer (including plans purchased through salary reduction contributions) for the participant are treated as one section 403(b) annuity contract.

(b) *Affiliated employers, affiliated service groups, and leased employees—*

(1) *General rule.* See § 1.415(a)–1(f)(1) and (2) for rules regarding aggregation of employers in the case of affiliated employers and affiliated service groups. See § 1.415(a)–1(f)(3) for rules regarding the treatment of leased employees.

(2) *Special rule in the case of the break-up of an affiliated employer or an affiliated service group—*(i) *In general.* A formerly affiliated plan of an employer is taken into account for purposes of applying paragraph (a) of this section to the employer, but the formerly affiliated plan is treated as if it had terminated immediately prior to the cessation of affiliation with sufficient assets to pay benefit liabilities under the plan, and had purchased annuities to provide plan benefits. See § 1.415(b)–1(b)(5)(i) for rules determining annual benefits under a terminated defined benefit plan under which annuities are purchased to provide plan benefits.

(ii) *Definitions.* For purposes of this paragraph (b)(2), a *formerly affiliated plan of an employer* is a plan that, immediately prior to the cessation of affiliation, was actually maintained by one or more of the entities that constitute the employer (as determined under the employer affiliation rules described in § 1.415(a)–1(f)(1) and (2)), and immediately after the cessation of affiliation, is not actually maintained by any of the entities that constitute the employer (as determined under the employer affiliation rules described in § 1.415(a)–1(f)(1) and (2)). For purposes of this paragraph (b)(2), a *cessation of affiliation* means the event that causes an entity to no longer be aggregated with one or more other entities as a single employer under the employer affiliation rules described in § 1.415(a)–1(f)(1) and (2) (such as the sale of a subsidiary outside a controlled group), or that causes a plan to not actually be maintained by any of the entities that constitute the employer under the employer affiliation rules of § 1.415(a)–1(f)(1) and (2) (such as a transfer of plan sponsorship outside of a controlled group).

(c) *Predecessor employer—*(1) *Where plan is maintained by successor.* For purposes of section 415 and regulations promulgated under section 415, a former employer is a predecessor employer with respect to a participant in a plan maintained by an employer if the employer maintains a plan under which the participant had accrued a benefit while performing services for the former employer (for example, the employer assumed sponsorship of the former employer's plan, or the employer's plan received a transfer of benefits from the former employer's plan), but only if that benefit is

provided under the plan maintained by the employer. In such a case, in applying the limitations of section 415 to a participant in a plan maintained by the employer, paragraph (a) of this section requires the plan to take into account benefits provided to the participant under plans that are maintained by the predecessor employer and that are not maintained by the employer. For this purpose, the formerly affiliated plan rules in paragraph (b)(2) of this section apply as if the employer and predecessor employer constituted a single employer under the rules described in § 1.415(a)–1(f)(1) and (2) immediately prior to the cessation of affiliation (and as if they constituted two, unrelated employers under the rules described in § 1.415(a)–1(f)(1) and (2) immediately after the cessation of affiliation) and cessation of affiliation was the event that gives rise to the predecessor employer relationship, such as a transfer of benefits or plan sponsorship.

(2) *Where plan is not maintained by successor.* With respect to an employer of a participant, a former entity that antedates the employer is a predecessor employer with respect to the participant if, under the facts and circumstances, the employer constitutes a continuation of all or a portion of the trade or business of the former entity. This will occur, for example, where formation of the employer constitutes a mere formal or technical change in the employment relationship and continuity otherwise exists in the substance and administration of the business operations of the former entity and the employer.

(d) *Special rules—*(1) *Nonduplication.* In applying the limitations of section 415 to a plan maintained by an employer, if the plan is aggregated with another plan pursuant to the aggregation rules of paragraph (a) of this section, a participant's benefits are not counted more than once in determining the participant's aggregate annual benefit or annual additions. For example, if a defined benefit plan is treated as if it terminated immediately prior to a cessation of affiliation under paragraph (b)(2) of this section, the plans maintained by the employer (as determined after the cessation of affiliation) that actually maintains the plan do not double count the annual benefit provided under the plan by aggregating under paragraph (a) of this section both the participant's annual benefit provided under the plan and the participant's annual benefit under the plan as a formerly affiliated plan (which is a plan that the employers formerly affiliated with the employer must take

into account as a terminated plan under the rules of paragraph (b)(2) of this section). Instead, the plans maintained by the employer include the annual benefit provided to the participant under the actual plan that the employer maintains. Similarly, if a defined benefit plan maintained by an employer (the transferee plan) receives a transfer of benefits from a defined benefit plan maintained by a predecessor employer (the transferor plan) and the transfer is described in § 1.415(b)–1(b)(3)(i)(B) (which requires the transferred benefits to be treated by the transferor plan as if the benefits were provided under a plan that must be aggregated with the transferor plan that terminated immediately prior to the transfer), the transferee plan does not double count the transferred benefits under paragraph (a) of this section by taking into account both the actual benefit provided under the transferee plan and the benefit provided under the deemed terminated plan that the predecessor employer is treated as maintaining (and that otherwise would have to be taken into account by the transferee plan under the predecessor employer aggregation rules of paragraph (a) of this section). Instead, the transferee plan takes into account the transferred benefits that are actually provided under transferee plan (see § 1.415(b)–1(b)(3)(i)(C)) and, pursuant to paragraph (c)(1) of this section, any nontransferred benefits provided under plans maintained by the predecessor employer with respect to a participant whose benefits have been transferred to the transferee plan.

(2) *Determination of years of participation for multiple plans.* If two or more defined benefit plans are aggregated under section 415(f) and this section for a particular limitation year, in applying the reduction for participation of less than ten years (as described in section 415(b)(5)(A)) to the dollar limitation under section 415(b)(1)(A), time periods that are counted as years of participation under any of the plans are counted in computing the limitation of the aggregated plans under this section.

(3) *Determination of years of service for multiple plans.* If two or more defined benefit plans are aggregated under section 415(f) and this section for a particular limitation year, in applying the reduction for service of less than ten years (as described in section 415(b)(5)(B)) to the compensation limitation under section 415(b)(1)(B), time periods that are counted as years of service under any of the plans are counted in computing the limitation of the aggregated plans under this section.

(e) *Previously unaggregated plans—*  
(1) *In general.* This paragraph (e) provides rules for those situations in which two or more existing plans, which previously were not required to be aggregated pursuant to section 415(f) and this section, are aggregated during a particular limitation year and, as a result, the limitations of section 415(b) or (c) are exceeded for that limitation year. Paragraph (e)(2) of this section provides rules for defined contribution plans that are first required to be aggregated pursuant to section 415(f) and this section in a plan year. Paragraph (e)(3) of this section provides rules for defined benefit plans that are first required to be aggregated pursuant to section 415(f) and this section, and for defined benefit plans under which a participant's benefit is frozen following aggregation.

(2) *Defined contribution plans.* Two or more defined contribution plans that are not required to be aggregated pursuant to section 415(f) and this section as of the first day of a limitation year do not fail to satisfy the requirements of section 415 with respect to a participant for the limitation year merely because they are aggregated later in that limitation year, provided that no annual additions are credited to the participant's account after the date on which the plans are required to be aggregated.

(3) *Defined benefit plans—*(i) *First year of aggregation.* Two or more defined benefit plans that are not required to be aggregated pursuant to section 415(f) and this section as of the first day of a limitation year do not fail to satisfy the requirements of section 415 for the limitation year merely because they are aggregated later in that limitation year, provided that no plan amendments increasing benefits with respect to the participant under either plan are made after the occurrence of the event causing the plan to be aggregated.

(ii) *All years of aggregation in which accrued benefits are frozen.* Two or more defined benefit plans that are required to be aggregated pursuant to section 415(f) and this section during a limitation year subsequent to the limitation year during which the plans were first aggregated do not fail to satisfy the requirements of section 415 with respect to a participant for the limitation year merely because they are aggregated if there have been no increases in the participant's accrued benefit derived from employer contributions (including increases as a result of increased compensation or service) under any of the plans within

the period during which the plans have been aggregated.

(f) *Section 403(b) annuity contracts—*  
(1) *In general.* In the case of a section 403(b) annuity contract, except as provided in paragraph (f)(2) of this section, the participant on whose behalf the annuity contract is purchased is considered for purposes of section 415 to have exclusive control of the annuity contract. Accordingly, except as provided in paragraph (f)(2) of this section, the participant, and not the participant's employer who purchased the section 403(b) annuity contract, is deemed to maintain the annuity contract, and such a section 403(b) annuity contract is not aggregated with a qualified plan that is maintained by the participant's employer.

(2) *Special rules under which the employer is deemed to maintain the annuity contract—*(i) *In general.* Where a participant on whose behalf a section 403(b) annuity contract is purchased is in control of any employer for a limitation year as defined in paragraph (f)(2)(ii) of this section (regardless of whether the employer controlled by the participant is the employer maintaining the section 403(b) annuity contract), the annuity contract for the benefit of the participant is treated as a defined contribution plan maintained by both the controlled employer and the participant for that limitation year. Accordingly, where a participant on whose behalf a section 403(b) annuity contract is purchased is in control of any employer for a limitation year, the section 403(b) annuity contract is aggregated with all other defined contribution plans maintained by that employer. In addition, in such a case, the section 403(b) annuity contract is aggregated with all other defined contribution plans maintained by the employee or any other employer that is controlled by the employee. Thus, for example, if a doctor is employed by a non-profit hospital to which section 501(c)(3) applies and which provides him with a section 403(b) annuity contract, and the doctor also maintains a private practice as a shareholder owning more than 50 percent of a professional corporation, then any qualified defined contribution plan of the professional corporation must be aggregated with the section 403(b) annuity contract for purposes of applying the limitations of section 415(c) and § 1.415(c)–1. For purposes of this paragraph (f)(2), it is immaterial whether the section 403(b) annuity contract is purchased as a result of a salary reduction agreement between the employer and the participant.

(ii) *Determination of when a participant is in control of an employer.* For purposes of paragraph (f)(2)(i) of this section, a participant is in control of an employer for a limitation year if, pursuant to § 1.415(a)–1(f)(1) and (2), a plan maintained by that employer would have to be aggregated with a plan maintained by an employer that is 100 percent owned by the participant. Thus, for example, if a participant owns 60 percent of the common stock of a corporation, the participant is considered to be in control of that employer for purposes of applying paragraph (f)(2)(i) of this section.

(3) *Aggregation of section 403(b) annuity with qualified plan of controlled employer.* If a section 403(b) annuity contract is aggregated with a qualified plan of a controlled employer in accordance with paragraph (f)(2) of this section, the plans must satisfy the limitations of section 415(c) both separately and on an aggregate basis. In applying separately the limitations of section 415 to the qualified plan and to the section 403(b) annuity contract, compensation from the controlled employer may not be aggregated with compensation from the employer purchasing the section 403(b) annuity contract (that is, without regard to § 1.415(c)–2(g)(3)).

(g) *Multiemployer plans*—(1) *Multiemployer plan aggregated with another multiemployer plan.* Pursuant to section 415(f)(3)(B), multiemployer plans, as defined in section 414(f), are not aggregated with other multiemployer plans for purposes of applying the limits of section 415.

(2) *Multiemployer plan aggregated with other plan*—(i) *Aggregation only for benefits provided by the employer.* Notwithstanding the rule of § 1.415(a)–1(e), a multiemployer plan, as defined in section 414(f), is permitted to provide that only the benefits under that multiemployer plan that are provided by an employer are aggregated with benefits under plans maintained by that employer that are not multiemployer plans. If the multiemployer plan so provides, then, where an employer maintains both a plan which is not a multiemployer plan and a multiemployer plan, only the benefits under the multiemployer plan that are provided by the employer are aggregated with benefits under the employer's plans other than multiemployer plans (in lieu of including benefits provided by all employers under the multiemployer plan pursuant to the generally applicable rule of § 1.415(a)–1(e)).

(ii) *Exception from aggregation for purposes of applying section*

*415(b)(1)(B) compensation limit.*

Pursuant to section 415(f)(3)(A), a multiemployer plan, as defined in section 414(f), is not aggregated with any other plan that is not a multiemployer plan for purposes of applying the compensation limit of section 415(b)(1)(B) and § 1.415(b)–1(a)(1)(ii).

(h) *Special rules for aggregating certain plans, etc.* If a plan, annuity contract or arrangement is subject to a special limitation in addition to, or instead of, the regular limitations described in section 415(b) or (c), and is aggregated under this section with a plan which is subject only to the regular section 415(b) or (c) limitations, the following rules apply:

(1) Each plan, annuity contract or arrangement which is subject to a special limitation must meet its own applicable limitation and each plan subject to the regular limitations of section 415 must meet its applicable limitation.

(2) The limitation for the aggregated plans is the larger of the applicable limitations for the separate plans.

(i) [Reserved.]

(j) *Examples.* The following examples illustrate the rules of this section. Except to the extent otherwise stated in an example, each entity is not and has never been affiliated with another entity under the employer affiliation rules of § 1.415(a)–1(f)(1) and (2), each entity has never maintained a qualified plan (other than the plans specifically mentioned in the example), and the limitation year for each qualified plan is the calendar year.

*Example 1.* (i) *Facts.* M was formerly an employee of ABC Corporation and is currently an employee of XYZ Corporation. ABC maintains a qualified defined benefit plan (Plan ABC) and a qualified defined contribution plan in which M participates and XYZ maintains a qualified defined benefit plan (Plan XYZ) and a qualified defined contribution plan in which M participates. ABC Corporation owns 60 percent of XYZ Corporation.

(ii) *Treatment as a single employer.* ABC Corporation and XYZ Corporation are members of a controlled group of corporations within the meaning of section 414(b) as modified by section 415(h). Because ABC Corporation and XYZ Corporation are members of a controlled group of corporations within the meaning of section 414(b) as modified by section 415(h), M is treated as being employed by a single employer under § 1.415(a)–1(f)(1).

(iii) *Plan aggregation.* Under paragraph (a)(1) of this section, the sum of M's annual benefit under Plan ABC and M's annual benefit under Plan XYZ is not permitted to exceed the limitations of section 415(b) and § 1.415(b)–1; and, under paragraph (a)(2) of this section, the sum of the annual additions to M's account under the defined

contribution plans maintained by ABC and XYZ may not exceed the limitations of section 415(c) and § 1.415(c)–1. For purposes of determining the limitations of section 415(b) and § 1.415(b)–1 for the aggregated plans, a year of service for either employer is considered as a year of service for purposes of § 1.415(b)–1(g)(2) (phase-in rules for the compensation limit) and a year of participation under either plan is considered as a year of participation for purposes of § 1.415(b)–1(g)(1) (phase-in rules for the dollar limit).

*Example 2.* (i) *Facts.* The facts are the same as in *Example 1*, except that ABC Corporation and XYZ Corporation do not maintain defined contribution plans. In addition, Participant O was formerly an employee of ABC Corporation and is currently an employee of XYZ Corporation. Participant O has an accrued benefit under the ABC Plan, but Participant O has no accrued benefit under the XYZ Plan. Effective January 1, 2010, ABC Corporation sells all of its shares of stock of XYZ Corporation to an unaffiliated entity, LMN Corporation (the 2010 stock sale). After the 2010 stock sale, XYZ Corporation continues to maintain Plan XYZ. LMN Corporation maintains a qualified defined benefit plan (Plan LMN). After the 2010 stock sale, M begins to accrue benefits under Plan LMN, but O does not participate in Plan LMN.

(ii) *Affiliated employer status of the corporations.* Immediately after the 2010 stock sale, ABC Corporation and XYZ Corporation are no longer members of a controlled group of corporations under section 414(b) (as modified by section 414(h)) and accordingly are no longer treated as a single employer under the employer affiliation rules of § 1.415(a)–1(f)(1). Immediately after the 2010 stock sale, LMN Corporation and XYZ Corporation are members of a controlled group of corporations under section 414(b) (as modified by section 414(h)) and accordingly are treated as a single employer under the employer affiliation rules of § 1.415(a)–1(f)(1).

(iii) *Treatment of plans maintained by ABC Corporation after the 2010 stock sale.* Under § 1.415(a)–1(f)(1), any plan maintained by any member of a controlled group of corporations is deemed maintained by all members of the controlled group, and paragraph (a)(1) of this section requires that, for purposes of applying the limitations of section 415(b), all defined benefit plans ever maintained by an employer (as determined under the affiliation rules of § 1.415(a)–1(f)(1) and (2)) are treated as one defined benefit plan. Therefore, defined benefit plans maintained by ABC Corporation must take into account the annual benefit of a participant provided under Plan XYZ in applying the limitations of section 415(b) to the participant because Plan XYZ is a plan that had once been maintained by ABC Corporation. However, beginning with the 2010 limitation year, the aggregation of the annual benefit accrued by a participant under Plan XYZ for purposes of testing defined benefit plans maintained by ABC Corporation is limited to the annual benefit accrued by the participant under Plan XYZ immediately

prior to the 2010 stock sale. This is because paragraph (b)(2)(i) of this section provides that a formerly affiliated plan of an employer is treated as if it had terminated immediately prior to the cessation of affiliation with sufficient assets to pay benefit liabilities under the plan, and had purchased annuities to provide plan benefits. The 2010 stock sale is a cessation of affiliation under paragraph (b)(2)(ii) of this section because this event caused XYZ Corporation to no longer be affiliated with ABC Corporation under the employer affiliation rules of § 1.415(a)–1(f)(1) and (2). Immediately after the 2010 stock sale, Plan XYZ is a formerly affiliated plan with respect to ABC Corporation under paragraph (b)(2)(ii) of this section because immediately prior to the cessation of affiliation, Plan XYZ was actually maintained by XYZ Corporation (which together with ABC Corporation constituted a single employer under the employer affiliation rules of § 1.415(a)–1(f)(1) and (2)), and immediately after the cessation of affiliation, Plan XYZ is not actually maintained by ABC Corporation or any other entity affiliated with it.

(iv) *Application of rules to Participants M and O with respect to plans maintained by ABC Corporation after the 2010 stock sale.* In applying the limitations of section 415(b) to Participant M for the 2010 limitation year and later limitation years, Plan ABC must take into account the annual benefit provided under Plan ABC to Participant M and the annual benefit provided under Plan XYZ to Participant M, but treating Plan XYZ as if it had terminated immediately prior to the 2010 stock sale with sufficient assets to pay benefit liabilities under the plan, and had purchased annuities to provide plan benefits. The aggregation of Plan XYZ with Plan ABC is irrelevant for purposes of Participant O because Participant O does not have any accrued benefit under Plan XYZ (as determined prior to the 2010 stock sale).

(v) *Treatment of plans maintained by LMN Corporation and XYZ Corporation after the 2010 stock sale.* Under § 1.415(a)–1(f)(1) and paragraph (a)(1) of this section, when applying the limitations of section 415(b) to a participant under Plans LMN and XYZ for the 2010 limitation year and later years, the annual benefit provided to the participant under Plans LMN, XYZ and ABC must be aggregated. Benefits under Plan ABC must be included in this aggregation because XYZ Corporation is deemed to have once maintained Plan ABC pursuant to § 1.415(a)–1(f)(1), and since LMN Corporation and XYZ Corporation constitute a single employer under § 1.415(a)–1(f)(1), paragraph (a)(1) of this section requires the aggregation of all defined benefit plans ever maintained by LMN Corporation and XYZ Corporation. However, in performing this aggregation, a participant's annual benefit under Plan ABC is limited to the annual benefit accrued by the participant immediately prior to the 2010 stock sale. This is because, pursuant to paragraph (b)(2)(i) of this section, Plan ABC is a formerly affiliated plan of LMN Corporation and XYZ Corporation.

(vi) *Application of rules to Participants M and O with respect to plans maintained by LMN Corporation and XYZ Corporation after*

*the 2010 stock sale.* In applying the limitation of section 415(b) to Participant M for the 2010 limitation year and later limitation years, Plan LMN and Plan XYZ must take into account the annual benefit provided under Plans LMN and XYZ to Participant M and the annual benefit provided under Plan ABC to Participant M as if Plan ABC had terminated immediately prior to the 2010 stock sale with sufficient assets to pay benefit liabilities under the plan, and had purchased annuities to provide plan benefits. Participant O does not have an accrued benefit under Plan LMN or Plan XYZ, so the aggregation of Plan ABC with Plans LMN and XYZ is currently irrelevant with respect to Participant O. However, if Participant O were to ever participate in Plans LMN or XYZ after the 2010 stock sale, Participant O's annual benefit under Plan ABC (determined as if Plan ABC terminated immediately prior to the 2010 stock sale) would have to be aggregated with any annual benefit that Participant O accrues under Plan LMN or Plan XYZ.

(vii) *Application of nonduplication rule.* In applying paragraph (a)(1) of this section to plans maintained by ABC Corporation after 2010 stock sale, plans maintained by ABC Corporation do not take into account the deemed termination of Plan ABC since ABC Corporation maintains Plan ABC after the cessation of affiliation. Similarly, in applying paragraph (a)(1) of this section to plans maintained by LMN Corporation and XYZ Corporation after the 2010 stock sale, plans maintained by LMN Corporation and XYZ Corporation do not take into account the deemed termination of Plan XYZ since XYZ Corporation maintains Plan XYZ after the cessation of affiliation. See paragraph (d)(1) of this section.

*Example 3. (i) Facts.* The facts are the same as in *Example 2*, except that on January 1, 2009, Plan ABC transfers Participant M's benefit to Plan XYZ.

(ii) *Treatment of plans maintained by ABC Corporation.* Pursuant to § 1.415(b)–1(b)(3)(i)(A), M's benefit that is transferred from Plan ABC to Plan XYZ is not treated as being provided under Plan ABC for the limitation year in which the transfer occurs (2009). This is because M's transferred benefit is otherwise required to be taken into account by Plan ABC for the 2009 limitation year since Plan XYZ must be aggregated with Plan ABC pursuant to paragraph (a)(1) of this section. This result does not change for the 2010 limitation year and later limitation years, where pursuant to paragraph (b)(2)(i) of this section, Plan XYZ becomes a formerly affiliated plan with respect to ABC Corporation due to the 2010 stock sale. Under paragraph (b)(2)(i) of this section, Plan XYZ (the formerly affiliated plan) is treated from the perspective of plans maintained by ABC Corporation (Plan ABC) as if Plan XYZ terminated immediately prior to the 2010 stock sale with sufficient assets to pay benefit liabilities under the plan, and had purchased annuities to provide plan benefits. However, the pre-2010 stock sale benefits of Plan XYZ include the January 1, 2009, transfer of Participant M's benefit. Thus, in the 2010 limitation year, M's transferred benefit is still otherwise required to be taken into account

by Plan ABC on account of the aggregation of Plan XYZ with Plan ABC pursuant to paragraph (a)(1) of this section, and therefore the transferred benefit is not treated as being provided by Plan ABC.

(iii) *Treatment of plans maintained by LMN Corporation and XYZ Corporation.* Pursuant to § 1.415(b)–1(b)(3)(i)(C), Participant M's benefit that is transferred to Plan XYZ from Plan ABC must be treated as provided under Plan XYZ for purposes of applying the limitations of section 415 to Plan XYZ with respect to Participant M for the limitation year in which the transfer occurs and later years. This result does not change on account of the 2010 stock sale. When applying the limitation of section 415 to Plans LMN and XYZ for the 2010 limitation year and later years, Plans LMN and XYZ must aggregate the annual benefit provided to a participant under each plan along with the participant's benefit under Plan ABC pursuant to § 1.415(a)–1(f)(1) and paragraph (a)(1) of this section. However, under paragraph (b)(2)(i) of this section, for the 2010 limitation year and later years, this aggregation of M's Plan ABC benefit only includes the annual benefit attributable to a participant's accrued benefit under Plan ABC immediately prior to the 2010 stock sale, which (due to the 2009 transfer) is zero.

*Example 4. (i) Facts.* The facts are the same as in *Example 2*, except that on January 1, 2011, Plan ABC transfers Participant M's benefit to Plan XYZ.

(ii) *Treatment of plans maintained by ABC Corporation for the 2011 limitation year and later years.* Pursuant to § 1.415(b)–1(b)(3)(i)(B), M's benefit that is transferred from Plan ABC to Plan XYZ during the 2011 limitation year is treated by Plan ABC for the 2011 limitation year and later years as if the transferred benefit were provided under a plan that must be aggregated with Plan ABC that terminated immediately prior to the transfer with sufficient assets to pay benefit liabilities under the plan, and had purchased annuities to provide plan benefits. This is because M's transferred benefit is not otherwise required to be taken into account by Plan ABC for the 2011 limitation year and later years pursuant to paragraphs (a)(1) and (b)(2)(i) of this section. While Plan ABC must take into account Participant M's annual benefit under Plan XYZ under paragraph (a)(1) of this section, Participant M's annual benefit for this purpose is limited under paragraph (b)(2)(i) of this section to M's accrued benefit under Plan XYZ immediately prior to the 2010 stock sale, and Participant M's pre-2010 stock sale accrued benefit under Plan XYZ excludes the 2011 transfer.

(iii) *Treatment of plans maintained by LMN Corporation and XYZ Corporation for the 2011 limitation year and later years.* Pursuant to § 1.415(b)–1(b)(3)(i)(C), Participant M's benefit that is transferred to Plan XYZ from Plan ABC must be treated as provided under Plan XYZ for purposes of applying the limitations of section 415 to Plan XYZ with respect to Participant M for the limitation year in which the transfer occurs and later years. In applying the limitations of section 415(b) to Plans LMN and XYZ with respect to Participant M for the 2010 limitation year and later years, the

annual benefit of Participant M under Plans ABC, LMN, and XYZ must be aggregated pursuant to § 1.415(a)–1(f)(1) and paragraph (a)(1) of this section, but for this purpose, Participant M's benefit under Plan ABC is treated as if it were provided under a plan that terminated immediately prior to the cessation of affiliation of ABC Corporation and XYZ Corporation with sufficient assets to pay benefit liabilities under the plan, and had purchased an annuity to provide Participant M's benefits. (See paragraph (b)(2)(i) of this section and *Example 2*.) In applying the limitations of section 415(b) to Plans LMN and XYZ with respect to Participant M for the 2011 limitation year and later years, the annual benefit of Participant M under Plans ABC, LMN, and XYZ still must be aggregated pursuant to § 1.415(a)–1(f)(1) and paragraph (a)(1) of this section. However, beginning with the 2011 limitation year, ABC Corporation is a predecessor employer with respect to LMN Corporation and XYZ Corporation with respect to Participant M on account of the transfer of benefits from Plan ABC to Plan XYZ, pursuant to paragraph (c)(1) of this section. Therefore, Plans LMN and XYZ must take into account benefits that Participant M accrued under Plan ABC after the January 1, 2010, cessation of affiliation of ABC Corporation and XYZ Corporation that were not transferred to Plan XYZ on January 1, 2011, pursuant to paragraphs (c)(1) and (d)(1) of this section. Since all of Participant M's benefit in Plan ABC is transferred to Plan XYZ on January 1, 2011, Participant M's annual benefit from Plan ABC for purposes of aggregating Plan ABC with Plans LMN and XYZ is zero.

*Example 5. (i) Facts.* The facts are the same as in *Example 2*, except that instead of the 2010 stock sale, XYZ Corporation sells some of its operating assets to LMN Corporation (and, under the facts and circumstances, the sale does not result in XYZ Corporation constituting a predecessor employer of LMN Corporation under the rules of paragraph (c)(2) of this section), and in connection with the asset sale, LMN Corporation assumes sponsorship of Plan XYZ in place of XYZ Corporation, effective January 1, 2010.

*(ii) Treatment of plans maintained by ABC Corporation and XYZ Corporation.* Pursuant to paragraph (a)(1) of this section, all defined benefit plans ever maintained by ABC Corporation and XYZ Corporation must be aggregated as a single defined benefit plan for purposes of applying the limitations of section 415(b). However, for purposes of determining the annual benefit under Plan XYZ for the 2010 limitation year and later years, the aggregation of a participant's benefit under Plan XYZ is limited to the participant's annual benefit accrued immediately prior to the January 1, 2010, transfer of sponsorship of Plan XYZ. This is because paragraph (b)(2)(i) of this section provides that a formerly affiliated plan of an employer is treated as if it were a plan that terminated immediately prior to the cessation of affiliation with sufficient assets to pay benefit liabilities under the plan, and had purchased annuities to provide plan benefits. The January 1, 2010, transfer of sponsorship of Plan XYZ is a cessation of affiliation under

paragraph (b)(2)(ii) of this section because this event causes Plan XYZ to no longer actually be maintained by either ABC Corporation or XYZ Corporation. Effective immediately after the January 1, 2010, transfer of sponsorship, Plan XYZ is a formerly affiliated plan with respect to ABC Corporation and XYZ Corporation under paragraph (b)(2)(ii) of this section because immediately prior to the cessation of affiliation, Plan XYZ was actually maintained by XYZ Corporation, and immediately after the cessation of affiliation, Plan XYZ is not actually maintained by either XYZ Corporation or ABC Corporation. Therefore, in applying the limitation of section 415(b) to Participant M for the 2010 limitation year and later limitation years, Plan ABC must take into account the annual benefit provided under Plan ABC to Participant M and the annual benefit provided under Plan XYZ to Participant M as if Plan XYZ had terminated immediately prior to the 2010 stock sale with sufficient assets to pay benefit liabilities under the plan, and had purchased annuities to provide plan benefits. The aggregation of Plan XYZ with Plan ABC is irrelevant for purposes of Participant O because Participant O does not have any accrued benefit under Plan XYZ (as determined prior to the 2010 transfer of sponsorship).

*(iii) Treatment of plans maintained by LMN Corporation.* Under paragraph (a)(1) of this section, all defined benefit plans ever maintained by LMN Corporation or a predecessor employer must be aggregated as a single plan for purposes of applying the limitations of section 415(b). ABC Corporation and XYZ Corporation constitute a predecessor employer pursuant to paragraph (c)(1) of this section with respect to the participants who participate in Plan XYZ on the date of the transfer of sponsorship of Plan XYZ (the transferred participants) from XYZ Corporation to LMN Corporation, such as Participant M. This is because, effective with the January 1, 2010, transfer of sponsorship, LMN Corporation maintains a plan (Plan XYZ) under which the participants accrued a benefit while performing services for XYZ Corporation (which is in turn affiliated with ABC Corporation under § 1.415(a)–1(f)(1) and such benefits are provided under a plan maintained by LMN Corporation. Therefore, for the 2010 limitation year and later years, the annual benefit under Plan ABC of the transferred participants (such as Participant M) must be aggregated with the annual benefit provided to such participants under Plans XYZ and LMN for purposes of determining whether Plan LMN or Plan XYZ satisfies the limitations of section 415(b). However, the aggregation of the transferred participants' Plan ABC annual benefits is limited to the annual benefit accrued under Plan ABC immediately prior to January 1, 2010, transfer of sponsorship. This is because, pursuant to paragraph (c)(1) of this section, Plan ABC is treated from the perspective of plans maintained by LMN Corporation as if Plan ABC had terminated immediately prior to the transfer of sponsorship of Plan ABC to LMN Corporation with sufficient assets to pay benefit liabilities under the plan, and had

purchased annuities to provide plan benefits. ABC Corporation and XYZ Corporation do not constitute a predecessor employer with respect to Participant O. Thus, if Participant O is a participant in Plan LMN or becomes a participant in Plan XYZ after the 2010 transfer of sponsorship, neither plan aggregates Participant O's Plan ABC benefits for purposes of satisfying section 415(b). In applying paragraph (a)(1) of this section to a participant, plans maintained by LMN Corporation do not double count the participant's annual benefit. See paragraph (d)(1) of this section. Thus, such plans do not aggregate the annual benefit provided under Plan XYZ with the annual benefit from the deemed termination of Plan XYZ that LMN Corporation's predecessor employer (which is ABC and XYZ Corporations) must take into account in applying paragraph (a)(1) of this section, and instead consider the annual benefit actually provided under Plan XYZ.

*Example 6. (i) Facts.* N is employed by a hospital which purchases an annuity contract described in section 403(b) on N's behalf for the current limitation year. N is in control of the hospital within the meaning of section 414(b) or (c), as modified by section 415(h). The hospital also maintains a qualified defined contribution plan during the current limitation year in which N participates.

*(ii) Conclusion.* Under section 415(k)(4), the hospital, as well as N, is considered to maintain the annuity contract. Accordingly, for N the sum of the annual additions under the qualified defined contribution plan and the annuity contract must satisfy the limitations of section 415(c) and § 1.415(c)–1.

*Example 7. (i) Facts.* The facts are the same as in *Example 6*, except that instead of being in control of the hospital, N is the 100 percent owner of a professional corporation P, which maintains a qualified defined contribution plan in which N participates.

*(ii) Conclusion.* Under section 415(k)(4), the professional corporation, as well as N, is considered to maintain the annuity contract. Accordingly, the sum of the annual additions under the qualified defined contribution plan maintained by professional corporation P and the annuity contract must satisfy the limitations of section 415(c) and § 1.415(c)–1. See § 1.415(g)–1(b)(3)(iv)(C)(2) for an example of the treatment of a contribution to a section 403(b) annuity contract that exceeds the limits of section 415(c) by reason of the aggregation required by this section.

*Example 8. (i) Facts.* J is an employee of two corporations, N and M, each of which has employed J for more than 10 years. N and M are not required to be aggregated pursuant to section 415(f) and this section. Each corporation has a qualified defined benefit plan in which J has participated for more than 10 years. Each plan provides a benefit which is equal to 75 percent of a participant's average compensation for the period of the participant's high-3 years of service and is payable in the form of a straight life annuity beginning at age 65. J's average compensation for the period of his high-3 years of service from each corporation is \$160,000. In July 2008, N Corporation becomes a wholly owned subsidiary of M Corporation.



(ii) *Plan aggregation analysis.* As a result of the acquisition of N Corporation by M Corporation, J is treated as being employed by a single employer under section 414(b). Therefore, because section 415(f)(1)(A) requires that all defined benefit plans of an employer be treated as one defined benefit plan, the two plans must be aggregated for purposes of applying the limitations of section 415. However, under paragraph (e)(3)(i) of this section, since the plans were not aggregated as of the first day of the 2008 limitation year (January 1, 2008), they will not be considered aggregated until the limitation year beginning January 1, 2009, provided that no plan amendment increasing benefits with respect to participant J is made after the acquisition of N by M.

(iii) *Application to Participant J.* J has a total benefit under the two plans of \$240,000, which, as a result of the plan aggregation, is in excess of the section 415(b) limit. However, under paragraph (e)(3)(ii) of this section, the limitations of section 415(b) and § 1.415(b)-1 applicable to J may be exceeded in this situation without plan disqualification so long as J's accrued benefit derived from employer contributions is not increased (that is, J's accrued benefit does not increase on account of increased compensation, service, participation, or other accruals) during the period within which the limitations are being exceeded.

**Example 9.** (i) *Facts.* A, age 30, owns all of the stock of X Corporation and also owns 10 percent of the stock of Z Corporation. F, A's father, directly owns 75 percent of the stock of Z Corporation. Both corporations have qualified defined contribution plans in which A participates. A's compensation (within the meaning of § 1.415(c)-2) for 2008 is \$20,000 from Z Corporation and \$150,000 from X Corporation. During the period January 1, 2008 through June 30, 2008, annual additions of \$20,000 are credited to A's account under the plan of Z Corporation, while annual additions of \$40,000 are credited to A's account under the plan of X Corporation. In both instances, the amount of annual additions represent the maximum allowable under section 415(c) and § 1.415(c)-1. On July 15, 2008, F dies, and A inherits all of F's stock in Z in 2008.

(ii) *Conclusion.* As of July 15, 2008, A is considered to be in control of X and Z Corporations, and the two plans must be aggregated for purposes of applying the limitations of section 415. However, even though A's total annual additions for 2008 are \$60,000, the limitations of section 415(c) and § 1.415(c)-1 are not violated for 2008, provided no annual additions are credited to A's accounts after July 15, 2008 (the date that A is first in control of Z) for the remainder of the 2008 limitation year.

**Example 10.** (i) *Facts.* P is a key employee of employer XYZ who participates in a qualified defined contribution plan (Plan X). P is also provided post-retirement medical benefits, and XYZ has taken into account a reserve for those benefits under section 419A(c)(2). In the 2008 limitation year, P's compensation is \$30,000 and P's annual additions under Plan X are \$5,000. Pursuant to section 419A(d), a separate account is maintained for P, and that account is credited

with an allocation of \$32,000 for the 2008 limitation year. It is assumed that the section 415(c)(1)(A) dollar limit for 2008 is \$46,000.

(ii) *Separate testing analysis.* Under paragraph (h)(1) of this section, Plan X and the individual medical account must separately satisfy the requirements of section 415(c), taking into account any special limit applicable to that arrangement. In this case, the contributions to Plan X separately satisfy the limitations of section 415(c). While the individual medical account is treated as a defined contribution plan subject to the rules of section 415(c), it is not subject to the 100 percent of compensation limit of section 415(c)(1)(B), so the contributions to that account satisfy the limitations of section 415(c).

(iii) *Aggregation analysis.* The sum of the annual additions under Plan X and the amounts contributed to the separate account on P's behalf must satisfy the requirements of section 415(c). Under paragraph (h)(2) of this section, the limit applicable to the aggregated plan is equal to the greater of the limits applicable to the separate plans. In this case, the limit applicable to the medical account is \$46,000 (which is greater than the limit of \$30,000 applicable to the qualified plan), so the limit that applies to the aggregated plan is \$46,000, and the aggregated plan satisfies the requirements of section 415.

■ **Par. 15.** Section 1.415(g)-1 is added to read as follows:

**§ 1.415(g)-1 Disqualification of plans and trusts.**

(a) *Disqualification of plans—(1) In general.* Under section 415(g) and this section, with respect to a particular limitation year, a plan (and the trust forming part of the plan) is disqualified in accordance with the rules provided in paragraph (b) of this section, if the conditions described in paragraph (a)(2) or (a)(3) of this section apply. For purposes of this paragraph (a), the determination of whether a plan or a group of aggregated plans exceeds the limitations imposed by section 415 for a particular limitation year is, except as otherwise provided, made by taking into account the aggregation of plan rules provided in section 415(f) and § 1.414(f)-1.

(2) *Defined contribution plans.* A plan is disqualified in accordance with the rules provided in paragraph (b) of this section if annual additions (as defined in § 1.415(c)-1(b)) with respect to the account of any participant in a defined contribution plan maintained by the employer exceed the limitations of section 415(c) and § 1.415(c)-1.

(3) *Defined benefit plans.* A plan is disqualified in accordance with the rules provided in paragraph (b) of this section if the annual benefit (as defined in § 1.415(b)-1(b)(1)) of a participant in a defined benefit plan maintained by the

employer exceeds the limitations of section 415(b) and § 1.415(b)-1.

(b) *Rules for disqualification of plans and trusts—(1) In general.* If any plan (including a trust which forms part of such plan) is disqualified for a particular limitation year under the rules set forth in this paragraph (b), then the disqualification is effective as of the first day of the first plan year containing any portion of the particular limitation year.

(2) *Single plan.* In the case of a single qualified defined benefit plan (determined without regard to section 415(f) and § 1.415(f)-1) maintained by the employer that provides an annual benefit (as defined in § 1.415(b)-1(b)(1)) in excess of the limitations of section 415(b) and § 1.415(b)-1 for any particular limitation year, such plan is disqualified in that limitation year. Similarly, if the employer only maintains a single defined contribution plan (determined without regard to section 415(f) and § 1.415(f)-1) under which annual additions (as defined in § 1.415(c)-1(b)) allocated to the account of any participant exceed the limitations of section 415(c) and § 1.415(c)-1 for any particular limitation year, such plan is also disqualified in that limitation year.

(3) *Multiple plans—(i) In general.* If the limitations of section 415(b) and § 1.415(b)-1, or section 415(c) and § 1.415(c)-1, are exceeded for a particular limitation year with respect to any participant solely because of the application of the aggregation rules of section 415(f)(1) and § 1.415(f)-1 (taking into account the rules of § 1.415(a)-1(f)), then one or more of the plans is disqualified in accordance with the ordering rules set forth in paragraph (b)(3)(ii) of this section, applied in accordance with the rules of application set forth in paragraph (b)(3)(iii) of this section, subject to the special rules set forth in paragraph (b)(3)(iv) of this section, until, without regard to annual benefits or annual additions under the disqualified plan or plans, the remaining plans satisfy the applicable limitations of section 415.

(ii) *Ordering rules—(A) Disqualification of ongoing plans other than multiemployer plans.* If there are two or more plans that have not been terminated at any time including the last day of the particular limitation year, and if one or more of those plans is a multiemployer plan described in section 414(f), then one or more of the plans (as needed to satisfy the limitations of section 415) that has not been terminated and is not a multiemployer plan is disqualified in that limitation year. For purposes of the preceding



sentence, the determination of whether a plan is a multiemployer plan described in section 414(f) is made as of the last day of the particular limitation year.

(B) *Disqualification of ongoing multiemployer plans.* If, after the application of paragraph (b)(3)(ii)(A) of this section, there are two or more plans and one or more of the plans has been terminated at any time including the last day of the particular limitation year, then one or more of the plans (as needed to satisfy the applicable limitations of section 415) that has not been so terminated (regardless of whether the plan is a multiemployer plan described in section 414(f)) is disqualified in that limitation year.

(iii) *Rules of application—(A) Employer elects which plan is disqualified.* If there are two or more plans of an employer within a group of plans one or more of which is to be disqualified pursuant to paragraph (b)(3)(ii)(A) or (B) of this section, then the employer may elect, in a manner determined by the Commissioner, which plan or plans are disqualified. If those two or more plans are involved because of the application of § 1.415(a)–1(f), the employers involved may elect, in a manner determined by the Commissioner, which plan or plans are disqualified. However, the election described in the preceding sentence is not effective unless made by all of those employers.

(B) *Commissioner determines which plan is disqualified.* If the election described in paragraph (b)(3)(iii)(A) of this section is not made with respect to the two plans described in paragraph (b)(3)(iii)(A) of this section, then the Commissioner, taking into account all of the facts and circumstances, has the discretion to determine the plan that is disqualified in the particular limitation year. In making this determination, some of the factors that will be taken into account include, but are not limited to, the number of participants in each plan, the amount of benefits provided on an overall basis by each plan, and the extent to which benefits are distributed or retained in each plan.

(iv) *Special rules—(A) Simplified employee pensions.* If there are two or more plans one or more of which is to be disqualified pursuant to paragraph (b)(3)(ii)(A) or (B) of this section, and if one of the plans is a simplified employee pension (as defined in section 408(k)), then the simplified employee pension is not disqualified until all of the other plans have been disqualified. However, if one of the plans has been terminated, then the simplified employee pension is disqualified before

the terminated plan. For purposes of this paragraph (b)(3)(iv)(A), the disqualification of a simplified employee pension means that the simplified employee pension is no longer described under section 408(k).

(B) *Aggregating medical accounts with defined contribution plans.* In the event that aggregating a medical account described in § 1.415(c)–1(a)(2)(ii)(C) or (D) and a defined contribution plan other than such a medical account causes the limitations of section 415(c) and § 1.415(c)–1 applicable to a participant to be exceeded for a particular limitation year, the defined contribution plan other than the medical account is disqualified for the limitation year.

(C) *Aggregating section 403(b) annuity contract and qualified defined contribution plan—(1) In general.* In the event that aggregating a section 403(b) annuity contract and a qualified defined contribution plan under the provisions of section 415(f)(1)(B) causes the limitations of section 415(c) and § 1.415(c)–1 applicable to a participant under the aggregated defined contribution plans to be exceeded for a particular limitation year, the excess of the contributions to the annuity contract plus the annual additions to the qualified plan over such limitations is attributed to the annuity contract and therefore includable in the gross income of the participant for the taxable year with or within which that limitation year ends. See § 1.415(a)–1(b)(2) for rules regarding the treatment of a contribution to a section 403(b) annuity contract that exceeds the limitations of section 415.

(2) *Example.* The following example illustrates the application of this paragraph (b)(3)(iv)(C). It is assumed for purposes of this example that the dollar limitation under section 415(c)(1)(A) that applies for all relevant limitation years is \$45,000. The example is as follows:

*Example.* (i) N is employed by a hospital which purchases an annuity contract described in section 403(b) on N's behalf for the current limitation year. N is also the 100 percent owner of a professional corporation P that maintains a qualified defined contribution plan during the current limitation year in which N participates. (The facts of this example are the same as in § 1.415(f)–1(j) *Example 7*.) N's compensation (within the meaning of § 1.415(c)–2) from the hospital for the current limitation year is \$150,000. For the current limitation year, the hospital contributes \$30,000 for the section 403(b) annuity contract on N's behalf, which is within the limitations applicable to N under the annuity contract (specifically, the limit under the annuity contract is \$45,000)). Professional corporation P also contributes

\$20,000 to the qualified defined contribution plan on N's behalf for the current limitation year (which represents the only annual additions allocated to N's account under the plan for such year), which is within the \$45,000 limitation of section 415(c)(1) applicable to N under the plan.

(ii) Under section 415(k)(4), the professional corporation, as well as N, is considered to maintain the annuity contract. Accordingly, the sum of the annual additions under the qualified defined contribution plan maintained by professional corporation P and the annuity contract must satisfy the limitations of section 415(c) and § 1.415(c)–1.

(iii) Because the total aggregate contributions (\$50,000) exceed the section 415(c) limitation applicable to N (\$45,000), \$5,000 of the \$30,000 contributed to the section 403(b) annuity contract is considered an excess contribution and therefore currently includable in N's gross income. The contract continues to be a section 403(b) annuity contract only if, for the current limitation year and all years thereafter, the issuer of the contract maintains separate accounts for each portion attributable to such excess contributions. See §§ 1.415(a)–1(b)(2).

(c) *Plan year for certain annuity contracts and individual retirement plans.* For purposes of this section, unless the plan under which the annuity contract or individual retirement plan is provided specifies that a different twelve-month period is considered to be the plan year—

(1) An annuity contract described in section 403(b) is considered to have a plan year coinciding with the taxable year of the individual on whose behalf the contract has been purchased; and

(2) A simplified employee pension described in section 408(k) is considered to have a plan year coinciding with the year under the plan that is used pursuant to section 408(k)(7)(C).

■ **Par. 16.** Section 1.415(j)–1 is added to read as follows:

**§ 1.415(j)–1 Limitation year.**

(a) *In general.* Unless the terms of a plan provide otherwise, the limitation year, with respect to any qualified plan maintained by the employer, is the calendar year.

(b) *Alternative limitation year election.* The terms of a plan may provide for the use of any other consecutive twelve month period as the limitation year. This includes a fiscal year with an annual period varying from 52 to 53 weeks, so long as the fiscal year satisfies the requirements of section 441(f). A plan may only provide for one limitation year regardless of the number or identity of the employers maintaining the plan.

(c) *Multiple limitation years—(1) In general.* Where an employer maintains

more than one qualified plan, those plans may provide for different limitation years. The rule described in this paragraph (c) also applies to a controlled group of employers (within the meaning of section 414(b) or (c), as modified by section 415(h)). If the plans of an employer (or a controlled group of employers whose plans are aggregated) have different limitation years, section 415 is applied in accordance with the rule of paragraphs (c)(2) and (3) of this section.

(2) *Testing rule for defined contribution plans.* If a participant is credited with annual additions in only one defined contribution plan, in determining whether the requirements of section 415(c) are satisfied, only the limitation year applicable to that plan is considered. However, if a participant is credited with annual additions in more than one defined contribution plan, each such plan satisfies the requirements of section 415(c) only if the limitations of section 415(c) are satisfied with respect to amounts that are annual additions for the limitation year with respect to the participant under the plan, plus amounts credited to the participant's account under all other plans required to be aggregated with the plan pursuant to section 415(f) and § 1.415(f)-1 that would have been considered annual additions for the limitation year under the plan if they had been credited under the plan rather than an aggregated plan.

(3) *Testing rule for defined benefit plans.* If a participant has participated in only one defined benefit plan, in determining whether the requirements of section 415(b) are satisfied, only the limitation year applicable to that plan is considered. However, if a participant has participated in more than one defined benefit plan, a plan satisfies the requirements of section 415(b) only if the annual benefit under all plans required to be aggregated pursuant to section 415(f) and § 1.415(f)-1 for the limitation year of that plan with respect to the participant satisfy the applicable limitations of section 415(b). Thus, for example, the dollar limitation of section 415(b)(1)(A) applicable to the limitation year for each plan must be applied to annual benefits under all aggregated plans to determine whether the plan satisfies the requirements of section 415(b).

(d) *Change of limitation year—(1) In general.* Once established, the limitation year may be changed only by amending the plan. Any change in the limitation year must be a change to a 12-month period commencing with any day within the current limitation year. For purposes of this section, the limitations

of section 415 are to be applied in the normal manner to the new limitation year.

(2) *Application to short limitation period.* Where there is a change of limitation year, the limitations of section 415 are to be separately applied to a limitation period which begins with the first day of the current limitation year and which ends on the day before the first day of the first limitation year for which the change is effective. In the case of a defined contribution plan, the dollar limitation with respect to this limitation period is determined by multiplying the applicable dollar limitation for the calendar year in which the limitation period ends by a fraction, the numerator of which is the number of months (including any fractional parts of a month) in the limitation period, and the denominator of which is 12. In the case of a defined benefit plan, no adjustment is made to the section 415(b) limitations to reflect a short limitation period.

(3) *Deemed change of limitation year.* If a defined contribution plan is terminated effective as of a date other than the last day of the plan's limitation year, the plan is treated for purposes of this section as if the plan was amended to change its limitation year. Thus, the rules of this paragraph (d) apply to the terminating plan's final limitation year.

(e) *Limitation year for individuals on whose behalf section 403(b) annuity contracts have been purchased.* The limitation year of an individual on whose behalf a section 403(b) annuity contract has been purchased by an employer is determined in the following manner.

(1) If the individual is not in control of any employer (within the meaning of § 1.415(f)-1(f)(2)(ii)), the limitation year is the calendar year. However, the individual may elect to change the limitation year to another twelve-month period. To do this, the individual must attach a statement to his or her income tax return filed for the taxable year in which the change is made. Any change in the limitation year must comply with the rules set forth in paragraph (d) of this section.

(2) If the individual is in control of an employer (within the meaning of § 1.415(f)-1(f)(2)(ii)), the limitation year is the limitation year of that employer.

(f) *Limitation year for individuals on whose behalf individual retirement plans are maintained.* The limitation year of an individual on whose behalf an individual retirement plan (within the meaning of section 7701(a)(37)) is maintained is determined in the manner described in paragraph (e) of this section.

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

*Example 1.* (i) Participant M is employed by both Employer A and Employer B, each of which maintains a qualified defined contribution plan. M participates in both of these plans. The limitation year for Employer A's plan is January 1 through December 31, and the limitation year for Employer B's plan is April 1 through March 31. Employer A and Employer B are both corporations, and Corporation X owns 100 percent of the stock of Employer A and Employer B.

(ii) The two plans in which M participates are required under section 415(f) to be aggregated for purposes of applying the limitations of section 415(c) to annual additions made with respect to M. Thus, for example, for the limitation year of Employer A's plan that begins January 1, 2008, annual additions with respect to M that are subject to the limitations of section 415(c) include both amounts that are annual additions with respect to M under Employer A's plan for the period beginning January 1, 2008, and ending December 31, 2008, and amounts contributed to Employer B's plan with respect to M that would have been considered annual additions for the period beginning January 1, 2008, and ending December 31, 2008, under Employer A's plan if those amounts had instead been contributed to Employer A's plan.

*Example 2.* In 2008, an employer with a qualified defined contribution plan using the calendar year as the limitation year elects to change the limitation year to a period beginning July 1 and ending June 30. Because of this change, the plan must satisfy the limitations of section 415(c) for the limitation period beginning January 1, 2008, and ending June 30, 2008. In applying the limitations of section 415(c) to this limitation period, the amount of compensation taken into account may only include compensation for this period. Furthermore, the dollar limitation for this period is the otherwise applicable dollar limitation for calendar year 2008, multiplied by 6/12.

■ **Par. 17.** Section 1.416-1 is amended by revising Q&A T-21 to read as follows: *§ 1.416-1 Questions and answers on top heavy plans.*

\* \* \* \* \*

T-21. Q. For purposes of testing whether an individual has compensation of more than \$150,000, what definition of compensation must be used?

A. The definition of compensation to be used is the definition in § 1.415(c)-2, however, compensation must be determined for a plan year, not a limitation year. Alternatively, compensation that would be stated on an employee's Form W-2, "Wage and Tax Statement," for the calendar year that ends with or within the plan year may be used, although amounts that would have been stated on the employee's Form W-2 but for an election under section 125, 132(f)(4),

401(k), 403(b), 408(k), 408(p)(2)(A)(i), or 457(b) must be included. A plan must use the same definition of compensation for all top-heavy plan purposes for which the definition in this Q and A must be used.

\* \* \* \* \*

■ **Par. 18.** Section 1.457-4 is amended by revising paragraph (d) to read as follows:

**§ 1.457-4 Annual deferrals, deferral limitations, and deferral agreements under eligible plans.**

\* \* \* \* \*

(d) *Deferrals after severance from employment, including sick, vacation, and back pay under an eligible plan—*  
(1) *In general.* An eligible plan may provide that a participant who has not had a severance from employment may elect to defer accumulated sick pay, accumulated vacation pay, and back pay under an eligible plan if the requirements of section 457(b) are satisfied. For example, the plan must provide, in accordance with paragraph (b) of this section, that these amounts may be deferred for any calendar month only if an agreement providing for the deferral is entered into before the beginning of the month in which the amounts would otherwise be paid or made available and the participant is an employee on the date the amounts would otherwise be paid or made available. For purposes of section 457, compensation that would otherwise be paid for a payroll period that begins before severance from employment is treated as an amount that would otherwise be paid or made available before an employee has a severance from employment. In addition, deferrals may be made for former employees with respect to compensation described in § 1.415(c)-2(e)(3)(i) (relating to certain compensation paid by the later of 2½ months after severance from employment or the end of the limitation year that includes the date of severance from employment). For this purpose, the calendar year is substituted for the limitation year. In addition, compensation described in § 1.415(c)-2(e)(4), (g)(4), or (g)(7) (relating to compensation paid to participants who are permanently and totally disabled or compensation relating to qualified military service under section 414(u)), provided those amounts represent compensation described in § 1.415(c)-2(e)(3)(i).

(2) *Examples.* The provisions of this paragraph (d) are illustrated by the following examples:

*Example 1.* (i) *Facts.* Participant G, who is age 62 in year 2007, is an employee who

participates in an eligible plan providing a normal retirement age of 65 and a bona fide sick leave and vacation pay program of the eligible employer. Under the terms of G's employer's eligible plan and the sick leave and vacation pay program, G is permitted to make a one-time election to contribute amounts representing accumulated sick pay to the eligible plan. G has a severance from employment on January 12, 2008, at which time G's accumulated sick and vacation pay that is payable on March 15, 2008, totals \$12,000. G elects, on February 4, 2008, to have the \$12,000 of accumulated sick and vacation pay contributed to the eligible plan.

(ii) *Conclusion.* Under the terms of the eligible plan and the sick and vacation pay program, G may elect before March 1, 2008, to defer the accumulated sick and vacation pay because the agreement providing for the deferral is entered into before the beginning of the month in which the amount is currently available and the amount is bona fide accumulated sick and vacation pay, as described in § 1.415(c)-2(e)(3)(ii), and that is payable by the later of 2½ months after severance from employment or the end of the calendar year that includes the date of severance from employment by G. Thus, under this section and § 1.415(c)-2(e)(3)(ii), the \$12,000 is included in G's includible compensation for purposes of determining G's includible compensation in year 2008.

*Example 2.* (i) *Facts.* Same facts as in *Example 1*, except that G's severance from employment is on May 31, 2008, G's \$12,000 of accumulated sick and vacation pay is payable on September 15, 2008 (which is by the later of 2½ months after severance from employment or the end of the calendar year that includes the date of severance from employment by G), and G's election to defer the accumulated sick and vacation pay is made before May 1, 2008.

(ii) *Conclusion.* Under this section and § 1.415(c)-2(e)(3)(ii), the \$12,000 is included in G's includible compensation for purposes of determining G's includible compensation in year 2008.

*Example 3.* (i) *Facts.* Employer X maintains an eligible plan and a vacation leave plan. Under the terms of the vacation leave plan, employees generally accrue three weeks of vacation per year. Up to one week's unused vacation may be carried over from one year to the next, so that in any single year an employee may have a maximum of four weeks' vacation time. At the beginning of each calendar year, under the terms of the eligible plan (which constitutes an agreement providing for the deferral), the value of any unused vacation time from the prior year in excess of one week is automatically contributed to the eligible plan, to the extent of the employee's maximum deferral limitations. Amounts in excess of the maximum deferral limitations are forfeited.

(ii) *Conclusion.* The value of the unused vacation pay contributed to X's eligible plan pursuant to the terms of the plan and the terms of the vacation leave plan is treated as an annual deferral to the eligible plan for January of the calendar year. No amounts contributed to the eligible plan will be considered made available to a participant in X's eligible plan.

\* \* \* \* \*

■ **Par. 19.** Section 1.457-5 is amended by revising paragraph (d) *Example 2* to read as follows:

**§ 1.457-5 Individual limitation for combined annual deferrals under multiple eligible plans.**

\* \* \* \* \*

(d) \* \* \*

*Example 2.* (i) *Facts.* Participant E, who will turn 63 on April 1, 2006, participates in four eligible plans during year 2006: Plan W which is an eligible governmental plan; and Plans X, Y, and Z which are each eligible plans of three different tax-exempt entities. For year 2006, the limitation that applies to Participant E under all four plans under § 1.457-4(c)(1)(i)(A) is \$15,000. For year 2006, the additional age 50 catch-up limitation that applies to Participant E under all four plans under § 1.457-4(c)(2) is \$5,000. Further, for year 2006, different limitations under § 1.457-4(c)(3) and (c)(3)(ii)(B) apply to Participant E under each of these plans, as follows: under Plan W, the underutilized limitation under § 1.457-4(c)(3)(ii)(B) is \$7,000; under Plan X, the underutilized limitation under § 1.457-4(c)(3)(ii)(B) is \$2,000; under Plan Y, the underutilized limitation under § 1.457-4(c)(3)(ii)(B) is \$8,000; and under Plan Z, § 1.457-4(c)(3) is not applicable since normal retirement age is 62 under Plan Z. Participant E's includible compensation is in each case in excess of any applicable deferral.

(ii) *Conclusion.* For purposes of applying this section to Participant E for year 2006, Participant E could elect to defer \$23,000 under Plan Y, which is the maximum deferral limitation under § 1.457-4(c)(1) through (3), and to defer no amount under Plans W, X, and Z. The \$23,000 maximum amount is equal to the sum of \$15,000 plus \$8,000, which is the catch-up amount applicable to Participant E under Plan Y and which is the largest catch-up amount applicable to Participant E under any of the four plans for year 2006. Alternatively, Participant E could instead elect to defer the following combination of amounts: an aggregate total of \$15,000 to Plans X, Y, and Z, if no contribution is made to Plan W; an aggregate total of \$20,000 to any of the four plans; or \$22,000 to Plan W and none to any of the other three plans.

(iii) If the underutilized amount under Plans W, X, and Y for year 2006 were in each case zero (because E had always contributed the maximum amount or E was a new participant) or an amount not in excess of \$5,000, the maximum exclusion under this section would be \$20,000 for Participant E for year 2006 (\$15,000 plus the \$5,000 age 50 catch-up amount), which Participant E could contribute to any of the plans.

■ **Par. 20.** Section 1.457-6 is amended by revising paragraphs (a) and (c) to read as follows:

**§ 1.457-6 Timing of distributions under eligible plans.**

(a) *In general.* Except as provided in paragraph (c) of this section (relating to distributions on account of an

unforeseeable emergency), paragraph (e) of this section (relating to distributions of small accounts), § 1.457–10(a) (relating to plan terminations), or § 1.457–10(c) (relating to domestic relations orders), amounts deferred under an eligible plan may not be paid to a participant or beneficiary before the participant has a severance from employment with the eligible employer or when the participant attains age 70½, if earlier. For rules relating to loans, see paragraph (f) of this section. This section does not apply to distributions of excess amounts under § 1.457–4(e). However, except to the extent set forth by the Commissioner in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin (see § 601.601(d) of this chapter), this section applies to amounts held in a separate account for eligible rollover distributions maintained by an eligible governmental plan as described in § 1.457–10(e)(2).

\* \* \* \* \*

(c) *Rules applicable to distributions for unforeseeable emergencies*—(1) *In general.* An eligible plan may permit a distribution to a participant or beneficiary for an unforeseeable emergency. The distribution must satisfy the requirements of paragraph (c)(2) of this section.

(2) *Requirements*—(i) *Unforeseeable emergency defined.* An unforeseeable emergency must be defined in the plan as a severe financial hardship of the participant or beneficiary resulting from an illness or accident of the participant or beneficiary, the participant's or beneficiary's spouse, or the participant's or beneficiary's dependent (as defined in section 152, and, for taxable years beginning on or after January 1, 2005, without regard to section 152(b)(1), (b)(2), and (d)(1)(B)); loss of the participant's or beneficiary's property due to casualty (including the need to rebuild a home following damage to a home not otherwise covered by homeowner's insurance, such as damage that is the result of a natural disaster); or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or the beneficiary. For example, the imminent foreclosure of or eviction from the participant's or beneficiary's primary residence may constitute an unforeseeable emergency. In addition, the need to pay for medical expenses, including non-refundable deductibles, as well as for the cost of prescription drug medication, may

constitute an unforeseeable emergency. Finally, the need to pay for the funeral expenses of a spouse or a dependent (as defined in section 152, and, for taxable years beginning on or after January 1, 2005, without regard to section 152(b)(1), (b)(2), and (d)(1)(B)) of a participant or beneficiary may also constitute an unforeseeable emergency. Except as otherwise specifically provided in this paragraph (c)(2)(i), the purchase of a home and the payment of college tuition are not unforeseeable emergencies under this paragraph (c)(2)(i).

(ii) *Unforeseeable emergency distribution standard.* Whether a participant or beneficiary is faced with an unforeseeable emergency permitting a distribution under this paragraph (c) is to be determined based on the relevant facts and circumstances of each case, but, in any case, a distribution on account of unforeseeable emergency may not be made to the extent that such emergency is or may be relieved through reimbursement or compensation from insurance or otherwise, by liquidation of the participant's assets, to the extent the liquidation of such assets would not itself cause severe financial hardship, or by cessation of deferrals under the plan.

(iii) *Distribution necessary to satisfy emergency need.* Distributions because of an unforeseeable emergency must be limited to the amount reasonably necessary to satisfy the emergency need (which may include any amounts necessary to pay for any federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution).

\* \* \* \* \*

■ **Par. 21.** Section 1.457–10 is amended by revising paragraph (b)(8) to read as follows:

**§ 1.457–10 Miscellaneous provisions.**

\* \* \* \* \*

(b) \* \* \*

(8) *Purchase of permissive service credit by plan-to-plan transfers from an eligible governmental plan to a qualified plan*—(i) *General rule.* An eligible governmental plan of a State may provide for the transfer of amounts deferred by a participant or beneficiary to a defined benefit governmental plan (as defined in section 414(d)), and no amount shall be includible in gross income by reason of the transfer, if the conditions in paragraph (b)(8)(ii) of this section are met. A transfer under this paragraph (b)(8) is not treated as a distribution for purposes of § 1.457–6.

Therefore, such a transfer may be made before severance from employment.

(ii) *Conditions for plan-to-plan transfers from an eligible governmental plan to a qualified plan.* A transfer may be made under this paragraph (b)(8) only if the transfer is either—

(A) For the purchase of permissive service credit (as defined in section 415(n)(3)(A)) under the receiving defined benefit governmental plan; or

(B) A repayment to which section 415 does not apply by reason of section 415(k)(3).

(iii) *Example.* The provisions of this paragraph (b)(8) are illustrated by the following example:

*Example.* (i) *Facts.* Plan X is an eligible governmental plan maintained by County Y for its employees. Plan X provides for distributions only in the event of death, an unforeseeable emergency, or severance from employment with County Y (including retirement from County Y). Plan S is a qualified defined benefit plan maintained by State T for its employees. County Y is within State T. Employee A is an employee of County Y and is a participant in Plan X. Employee A previously was an employee of State T and is still entitled to benefits under Plan S. Plan S includes provisions allowing participants in certain plans, including Plan X, to transfer assets to Plan S for the purchase of service credit under Plan S and does not permit the amount transferred to exceed the amount necessary to fund the benefit resulting from the service credit. Although not required to do so, Plan X allows Employee A to transfer assets to Plan S to provide a service benefit under Plan S.

(ii) *Conclusion.* The transfer is permitted under this paragraph (b)(8).

\* \* \* \* \*

**PART 11—TEMPORARY INCOME TAX REGULATIONS UNDER THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974**

■ **Par. 22.** The authority citation for part 11 continues to read in part as follows:

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

**§ 11.415(c)(4)–1 [Removed]**

■ **Par. 23.** Section 11.415(c)(4)–1 is removed.

**Kevin M. Brown,**

*Deputy Commissioner for Services and Enforcement.*

Approved: March 20, 2007.

**Eric Solomon,**

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