• Amendment 25–72 for §§ 25.783(g) and 25.177.
• Amendment 25–75 for § 25.729(e).
• Amendment 25–79 for § 25.811(e)(2).
• Amendment 25–80 for § 25.1316.

In addition, the certification basis includes certain special conditions, exemptions, or later amended sections of the applicable part that are not relevant to this proposed special condition.

If the Administrator finds that the applicable airworthiness regulations (*i.e.,* part 25) do not contain adequate or appropriate safety standards for the Falcon Model 2000EX because of a novel or unusual design feature, special conditions are prescribed under the provisions of § 21.16.

In addition to the applicable airworthiness regulations and special conditions, the Falcon Model 2000EX must comply with the fuel-vent and exhaust-emission requirements of 14 CFR part 34 and the noise certification requirements of 14 CFR part 36.

The FAA issues special conditions, as defined in 14 CFR 11.19, in accordance with § 11.38, and they become part of the type-certification basis under § 21.101.

Special conditions are initially applicable to the model for which they are issued. Should the type certificate for that model be amended later to include any other model that incorporates the same novel or unusual design feature, or should any other model already included on the same type certificate be modified to incorporate the same novel or unusual design feature, the special conditions would also apply to the other model under § 21.101.

Novel or Unusual Design Features

The Falcon Model 2000EX will incorporate the following novel or unusual design features:

The airplane will be equipped with an automatic braking system, which is a pilot-selectable function that allows earlier maximum braking at landing without pilot pedal input. When the autobrake system is armed before landing, it automatically commands maximum braking at main wheels touchdown. This will cause a high nose gear sink rate, and potentially higher gear and airframe loads than would occur with a traditional braking system. Therefore, the FAA has determined that a special condition is needed.

Discussion

The special condition defines a landing pitchover condition that takes into account the effects of the automatic braking system. The special condition defines the airplane configuration, speeds, and other parameters necessary to develop airframe and nose gear loads for this condition. The special condition requires that the airplane be designed to support the resulting limit and ultimate loads as defined in § 25.305.

Discussion of Comments

Notice of proposed special conditions No. 25–09–13–SC for the Dassault Aviation Falcon Model 2000EX airplanes was published in the **Federal Register** on December 10, 2009. No comments were received, and the special conditions are adopted as proposed.

Applicability

As discussed above, these special conditions are applicable to the Falcon Model 2000EX. Should Dassault Aviation apply at a later date for a change to the type certificate to include another model on the same type certificate incorporating the same novel or unusual design feature, the special conditions would apply to that model as well.

Conclusion

This action affects only certain novel or unusual design features on one model of airplanes. It is not a rule of general applicability.

List of Subjects in 14 CFR Part 25

Aircraft, Aviation safety, Reporting and recordkeeping requirements.

The authority citation for these special conditions is as follows:

Authority: 49 U.S.C. 106(g), 40113, 44701, 44702, 44704.

The Special Conditions

Accordingly, pursuant to the authority delegated to me by the Administrator, the following special conditions are issued as part of the type certification basis for Dassault Aviation Falcon Model 2000EX airplanes.

Landing Pitchover Condition

A landing pitchover condition must be addressed that takes into account the effect of the autobrake system. The airplane is assumed to be at the design maximum landing weight, or at the maximum weight allowed with the autobrake system on. The airplane is assumed to land in a tail-down attitude and at the speeds defined in § 25.481. Following main gear contact, the airplane is assumed to rotate about the main gear wheels at the highest pitch rate allowed by the autobrake system. This is considered a limit load condition from which ultimate loads must also be determined. Loads must be determined for critical fuel and payload distributions and centers of gravity. Nose gear loads, as well as airframe loads, must be determined. The airplane must support these loads as described in § 25.305.

Issued in Renton, Washington, on May 12, 2010.

Ali Bahrami,

Manager, Transport Airplane Directorate, Aircraft Certification Service.

[FR Doc. 2010–11932 Filed 5–18–10; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9484]

RIN 1545–BH04

Diversification Requirements for Certain Defined Contribution Plans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 401(a)(35) of the Internal Revenue Code (Code) relating to diversification requirements for certain defined contribution plans holding publicly traded employer securities. These regulations will affect administrators of, employers maintaining, participants in, and beneficiaries of defined contribution plans that are invested in employer securities.

DATES: *Effective date:* These regulations are effective on May 19, 2010.

Applicability date: These regulations apply for plan years beginning on or after January 1, 2011.

FOR FURTHER INFORMATION CONTACT: R. Lisa Mojiri-Azad or Jamie Dvoretzky at (202) 622–6060 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations under section 401(a)(35) of the Code, which was added by section 901 of the Pension Protection Act of 2006, Public Law 109–280 (120 Stat. 780 (2006)) (PPA '06).[1]

[1] Section 901 of PPA '06 also added a parallel provision to section 401(a)(35) at section 204(j) of the Employee Retirement Income Security Act of 1974, Public Law 93–406 (88 Stat. 829 (1974)) (ERISA). Under section 101 of Reorganization Plan No. 4 of 1978 (43 FR 47713), the Secretary of

Continued

Section 401(a)(35)(A) provides that a trust which is part of an applicable defined contribution plan is not a qualified trust under section 401(a) unless the plan satisfies the diversification requirements of section 401(a)(35)(B), (C), and (D). Under section 401(a)(35)(B), each individual must have the right to direct the plan to divest employer securities allocated to the individual's account that are attributable to employee contributions or elective deferrals and to reinvest an equivalent amount in other investment options meeting the requirements of section 401(a)(35)(D).[2]

Under section 401(a)(35)(C), each individual who is a participant who has completed at least three years of service, a beneficiary of a participant who has completed at least three years of service, or a beneficiary of a deceased participant must be permitted to elect to direct the plan to divest employer securities allocated to the individual's account and to reinvest an equivalent amount in other investment options meeting the requirements of section 401(a)(35)(D).

Section 401(a)(35)(D)(i) requires an applicable defined contribution plan to offer individuals not less than three investment options, other than employer securities, to which the individuals may direct the proceeds from the divestment of employer securities, each of which is diversified and has materially different risk and return characteristics.

Under section 401(a)(35)(D)(ii)(I), a plan does not fail to meet the requirements of section 401(a)(35)(D) if it allows individuals to divest employer securities and reinvest the proceeds at periodic, reasonable opportunities occurring no less frequently than quarterly.

Under section 401(a)(35)(D)(ii)(II), a plan is not permitted to impose restrictions or conditions with respect to the investment of employer securities that are not imposed on the investment of other assets of the plan. However, this rule does not apply to restrictions or conditions imposed to comply with securities laws. The Secretary is authorized to issue regulations providing additional exceptions to the requirements of section 401(a)(35)(D)(ii)(II).

An applicable defined contribution plan under section 401(a)(35) is a defined contribution plan that holds any publicly traded employer securities. A publicly traded employer security is defined as an employer security under section 407(d)(1) of the Employee Retirement Income Security Act of 1974, Public Law 93–406 (88 Stat. 829 (1974)) (ERISA) which is readily tradable on an established securities market. Section 401(a)(35)(F)(i) provides that a plan that holds employer securities that are not publicly traded employer securities is nevertheless treated as holding publicly traded employer securities if any employer corporation or any member of a controlled group of corporations which includes the employer (determined by applying section 1563(a), except substituting 50 percent for 80 percent) has issued a class of stock that is a publicly traded employer security. However, section 401(a)(35)(F) does not apply to a plan if no employer corporation, or parent corporation (as defined in section 424(e)) of an employer corporation, has issued any publicly traded employer security and no employer or parent corporation has issued any special class of stock which grants particular rights to, or bears particular risks for, the holder or issuer with respect to any corporation described in section 401(a)(35)(F)(i) which has issued any publicly traded employer security.

Section 401(a)(35)(E) provides that section 401(a)(35) does not apply to an employee stock ownership plan within the meaning of section 4975(e)(7) (ESOP) that holds no contributions (or earnings thereunder) that are subject to section 401(k) or (m) (generally relating to elective deferrals and matching and employee after-tax contributions) and the ESOP is a separate plan for purposes of section 414(l) with respect to any other defined benefit plan or defined contribution plan maintained by the same employer or employers. Section 401(a)(35)(E) further provides that section 401(a)(35) does not apply to one-participant retirement plans (within the meaning of section 401(a)(35)(E)(iv)).

Section 401(a)(35) is generally effective for plan years beginning after December 31, 2006. Section 401(a)(35)(H) generally provides a three year phase-in rule with respect to an individual's right to direct the divestment of employer securities attributable to employer contributions, except with respect to certain participants who have attained age 55. Section 901(c)(2) of PPA '06 includes a special rule for a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers that was ratified on or before August 17, 2006. Under this rule, section 401(a)(35) is not effective until plan years beginning after the earlier of (1) the later of (a) December 31, 2007 or (b) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after August 17, 2006) or (2) December 31, 2008.

Section 101(m) of ERISA as amended by section 507 of PPA '06 requires the plan administrator to furnish a notice to individuals not later than 30 days before the first date on which an individual is eligible to exercise his or her right to divest employer securities with respect to any type of contribution. The notice must set forth the diversification rights under section 204(j) of ERISA (which is the parallel provision in ERISA to section 401(a)(35)) and describe the importance of diversifying the investment of retirement account assets.

Notice 2006–107 (2006–2 CB 1114 (December 18, 2006)), (see § 601.601(d)(2)(ii)(*b*)) includes guidance and transitional rules with respect to the diversification requirements of section 401(a)(35). Notice 2006–107 also includes guidance regarding the related notice requirements of section 101(m) of ERISA, including a model notice. Notice 2008–7 (2008–3 IRB 276 (January 22, 2008)), (see § 601.601(d)(2)(ii)(*b*)) extends the transitional guidance and transitional relief that was included in Notice 2006–107 until the final regulations become effective.

Notice 2009–97 (2009–52 IRB 972 (December 28, 2009)), (see § 601.601(d)(2)(ii)(*b*)) extends the deadline for adopting an interim or discretionary plan amendment under certain provisions of PPA '06, including section 401(a)(35), to the last day of the first plan year that begins on or after January 1, 2010.

On January 3, 2008, proposed regulations (REG–136701–07) under section 401(a)(35) of the Code were published in the **Federal Register** (73 FR 421). No public hearing was requested. Written comments responding to the notice of proposed rulemaking were received. After consideration of all the comments, the proposed regulations are adopted, as amended by this Treasury decision. The most significant revisions are discussed in the Summary of Comments and Explanation of Revisions.

Treasury has interpretative jurisdiction over the subject matter addressed in these final regulations for purposes of section 204(j) of ERISA. Thus, the guidance provided in these final regulations with respect to section 401(a)(35) of the Code also applies for purposes of section 204(j) of ERISA.

[2] Section 401(a)(28)(B) provides certain diversification rights to participants in an employee stock ownership plan within the meaning of section 4975(e)(7) (ESOP). Section 401(a)(28)(B)(v), as added by section 901(a)(2)(A) of PPA '06, provides that section 401(a)(28)(B) does not to apply to a plan to which section 401(a)(35) applies.

Summary of Comments and Explanation of Revisions

Certain Defined Contribution Plans or Investment Funds Not Treated as Holding Employer Securities

The proposed regulations provided that certain investment funds that include employer securities as part of a broader fund were treated as not holding employer securities. This exception was limited to the extent the employer securities were held indirectly through an investment company registered under the Investment Company Act of 1940; a common or collective trust fund or pooled investment fund maintained by a bank or trust company supervised by a State or a Federal agency; a pooled investment fund of an insurance company that is qualified to do business in a State; or any other investment fund designated by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin. The proposed regulations also provided that this exception was limited to funds where the investment is independent of the employer and where the employer securities do not exceed 10 percent of the fund.

Commentators requested that this exception be broadened to include funds that are managed by an investment manager within the meaning of section 3(38) of ERISA. The final regulations do not provide for this expansion because such a fund would not necessarily be holding employer securities only as an indirect result of its investment policy. However, the final regulations provide that, in the case of a multiemployer plan, an investment option will not be treated as holding employer securities to the extent the employer securities are held indirectly through an investment fund managed by an investment manager if the investment is independent of the employer and the percentage limitation rule is satisfied.

The final regulations replace the reference to a fund that is an investment company registered under the Investment Company Act of 1940 with a regulated investment company as described in Code section 851(a). This change extends the types of investment companies to include exchange traded funds, which are unit investment trusts if they satisfy section 851(a). The final regulations also retain the rule from the proposed regulations that allows the Commissioner to designate additional types of funds as eligible for this exception.

Commentators requested that the percentage limitation rule be eliminated. They argued that it would be difficult and costly to monitor the investment fund to ensure that the aggregate value of the employer securities held in such fund was not in excess of 10 percent of the total assets of all the fund's investments. In response to these comments, the final regulations provide that the determination of whether the value of employer securities exceeds 10 percent of the total value of the fund's investments is made for the plan year as of the end of the preceding plan year. The determination can be based on the information in the latest disclosure of the fund's portfolio holdings (for example, Form N–CSR, "Certified Shareholder Report of Registered Management Investment Companies") that was filed with the Securities and Exchange Commission in that preceding plan year.

The final regulations also provide that in a case where a fund that indirectly holds employer securities fails to meet the requirement that the investment be independent of the employer (including the situation where the fund no longer meets the percentage limitation rule), the plan does not fail to satisfy the diversification requirements under section 401(a)(35) merely because it does not offer those rights for up to 90 days after the investment fund is treated as holding employer securities.

Prohibition on Restrictions or Conditions

Section 401(a)(35)(D)(ii)(II) provides that a plan is not permitted to impose restrictions or conditions with respect to the investment of employer securities that are not imposed on the investment of other assets of the plan. Like the proposed regulations, the final regulations provide that the prohibition on restrictions or conditions with respect to the investment of employer securities applies to any direct or indirect restriction on an individual's right to divest an investment in employer securities that is not imposed on an investment that is not employer securities, as well as a direct or indirect benefit that is conditioned on investment in employer securities.

The proposed regulations provided for a number of permitted restrictions and conditions. The proposed regulations would have permitted a plan to impose a restriction or condition either directly or indirectly because of applicable securities laws or because the plan becomes an applicable defined contribution plan, limits investments in employer securities, limits trading frequency, does not permit investment in a frozen fund, imposes a fee on other investment options that is not imposed on the investment in employer securities or imposes a reasonable fee on the divestment of employer securities, or allows investments to be made in a stable value or similar fund more frequently than other investment funds.

A commentator requested clarification with respect to the exception for frozen funds. The commentator requested that a frozen fund include a plan that reinvests employer security dividends in additional employer securities as long as the plan does not permit any further investment in employer securities. The final regulations clarify that the plan is permitted to allow reinvestment of dividends paid on employer securities. The final regulations also clarify that the frozen fund exception is only available for a plan that does not have another employer securities fund.

Commentators requested that the list for permitted indirect restrictions or conditions be expanded to include certain defined contribution plans that make matching contributions in employer securities and allow participants to divest employer securities attributable to such contributions, but do not permit participants to later elect to reinvest any portion of their account balances in employer stock. The final regulations do not adopt this suggestion. The IRS and the Treasury Department (Treasury) have concluded that the inability to reinvest in employer securities generally acts as a material deterrent to an individual who might otherwise have elected to diversify his or her account balance of employer securities. However, the final regulations provide a transitional rule for certain leveraged ESOPs. An employer stock fund does not fail to be a frozen fund merely because of the allocation of employer securities that are released as matching contributions from the plan's suspense account that holds employer securities acquired with an exempt loan under section 4975(d)(3). This transitional rule only applies to employer securities that were acquired in a plan year beginning before January 1, 2007, with the proceeds of an exempt loan within the meaning of section 4975(d)(3) which is not refinanced after the end of the last plan year beginning before January 1, 2007. This transitional rule was added because these leveraged ESOPs cannot cease allocations of employer securities acquired with an exempt loan that are held in a suspense account without significant effect on the company's debt arrangements.

Commentators suggested that the special rule for a stable value or similar fund be expanded to allow transfers out of a stable value fund or similar fund more frequently than other funds. In response to comments, the final regulations provide that a plan is generally permitted to allow transfers to be made into or out of a stable value fund more frequently than a fund invested in employer securities. Thus, a plan that includes a broad range of investment alternatives as described in section 401(a)(35)(D)(i), including a stable value or similar fund, does not impose an impermissible restriction merely because it permits transfers into and out of the stable value or similar fund more frequently than the other funds (taking into account any restrictions or conditions imposed with respect to the other investment options under the plan).

Commentators requested clarification as to the meaning of a stable value or similar fund. The final regulations provide that a stable value or similar fund means an investment product or fund designed to preserve or guarantee principal and provide a reasonable rate of return, while providing liquidity for benefit distributions or transfers to other investment alternatives (such as a product or fund described in Department of Labor Regulation section 2550.404c–5(e)(4)(iv)(A) or (v)(A)).

One commentator noted that the Department of Labor regulations for qualified default investment alternatives (QDIAs) require QDIAs to be restriction-free for 90 days. The commentator requested clarification that the restriction-free 90-day period does not cause a plan to violate the prohibition on imposing a restriction or condition with respect to employer securities that is not imposed on other investments. However, the commentator further stated that service providers will have difficulty administering restrictions only after 90 days and therefore requested that the final regulations permit restriction-free transfers for QDIAs permanently. The final regulations expand the list of permitted indirect restrictions to provide that a plan may provide for transfers out of a QDIA (within the meaning of Department of Labor Regulation section 2550.404c–5(e)) more frequently than a fund invested in employer securities.

A commentator requested clarification concerning plans being permitted to restrict reinvestments in only one employer stock fund when the plan allows investment in another employer stock fund, provided that the stock contained in each fund has the same characteristics except for differences in the tax cost basis of the trust. The final regulations provide that any applicable tax consequences are disregarded in determining whether a plan imposes an indirect restriction or condition on an individual's right to divest an investment in employer securities. Accordingly, a plan is permitted to provide that an individual may not reinvest divested amounts in the same employer securities account but is permitted to invest such divested amounts in another employer securities account where the only relevant difference between the separate accounts is the section 402(e)(4) cost (or other basis) of the trust in the shares held in each account.

Several commentators requested clarification regarding the 7-day rule in the proposed regulations. The preamble to the proposed regulations explained that the 7-day rule was an example and not the exclusive method to limit trading frequency. The permitted restriction for trading frequency provides that a plan is permitted to impose reasonable restrictions that are designed to limit short-term trading in employer securities. Thus, the 7-day rule, which was mentioned in the preamble to the proposed regulations, is an example and other short-term trading restrictions (such as a restriction based on multiple trades within a specified period) are allowable if they meet the reasonably designed standard.

Miscellaneous

Commentators requested clarification with respect to an ESOP that has been satisfying the diversification requirements under section 401(a)(28) by distributing the portion of the participant's account covered by an election within 90 days after the period during which the election may be made, but which is now subject to the diversification requirements under section 401(a)(35). Such a distribution option does not satisfy the diversification requirements under section 401(a)(35). These commentators were concerned that an amendment which eliminates this distribution option would be a violation of the anti-cutback rules under section 411(d)(6). Section 1107 of PPA '06 provides that any amendment which is made pursuant to a provision of PPA '06 will not fail to meet the requirements of section 411(d)(6) unless otherwise provided by the Secretary of the Treasury.[3] Thus, an amendment to an ESOP which is now subject to the diversification requirements under section 401(a)(35) that eliminates the distribution option available for ESOPs subject to the diversification requirements under section 401(a)(28), as permitted under section 1107 of PPA '06, would not violate the anti-cutback rules under section 411(d)(6).

In addition, it is expected that guidance will be issued in the near future exercising the authority under § 1.411(d)–4, A–2(d)(4), to permit elimination of such a distribution option with respect to an ESOP that is subject to section 401(a)(35) after the end of the limited period to which section 1107 of PPA '06 applies. The guidance will permit elimination of such a distribution option during the extended remedial amendment period permitted with respect to section 401(a)(35) under Notice 2009–97, that is, to the last day of the first plan year that begins on or after January 1, 2010.

Effective/Applicability Date

The final regulations are effective and applicable for plan years beginning on or after January 1, 2011.

For the period after the statutory effective date and before the regulatory effective date set forth in the preceding sentence, a plan must comply with section 401(a)(35). During this period, a plan is permitted to rely on Notice 2006–107, the proposed regulations, or these final regulations for purposes of satisfying the requirements of section 401(a)(35).

Special Analyses

It has been determined that these final regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because § 1.401(a)(35)–1 would 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 preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comments on its impact on small business.

Drafting Information

The principal authors of these regulations are Dana A. Barry, formerly of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), and R. Lisa Mojiri-Azad, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However,

[3] See also section 411(d)(6)(C)(ii).

other personnel from the IRS and the Treasury Department participated in the development of these regulations.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.401(a)(35)–1 is also issued under 26 U.S.C. 401(a)(35). * * *

■ **Par. 2.** Section 1.401(a)(35)–1 is added to read as follows:

§ 1.401(a)(35)–1 Diversification requirements for certain defined contribution plans.

(a) *General rule*—(1) *Diversification requirements.* Section 401(a)(35) imposes diversification requirements on applicable defined contribution plans. A trust that is part of an applicable defined contribution plan is not a qualified trust under section 401(a) unless the plan—

(i) Satisfies the diversification election requirements for elective deferrals and employee contributions set forth in paragraph (b) of this section;

(ii) Satisfies the diversification election requirements for employer nonelective contributions set forth in paragraph (c) of this section;

(iii) Satisfies the investment option requirement set forth in paragraph (d) of this section; and

(iv) Does not apply any restrictions or conditions on investments in employer securities that violate the requirements of paragraph (e) of this section.

(2) *Definitions, effective dates, and transition rules.* The definitions of applicable defined contribution plan, employer security, parent corporation, and publicly traded are set forth in paragraph (f) of this section. Applicability dates and transition rules are set forth in paragraph (g) of this section.

(b) *Diversification requirements for elective deferrals and employee contributions invested in employer securities*—(1) *General rule.* With respect to any individual described in paragraph (b)(2) of this section, if any portion of the individual's account under an applicable defined contribution plan attributable to elective deferrals (as described in section 402(g)(3)(A)), employee contributions, or rollover contributions is invested in employer securities, then the plan satisfies the requirements of this paragraph (b) if the individual may elect to divest those employer securities and reinvest an equivalent amount in other investment options. The plan may limit the time for divestment and reinvestment to periodic, reasonable opportunities occurring no less frequently than quarterly.

(2) *Applicable individual with respect to elective deferrals and employee contributions.* An individual is described in this paragraph (b)(2) if the individual is—

(i) A participant;

(ii) An alternate payee who has an account under the plan; or

(iii) A beneficiary of a deceased participant.

(c) *Diversification requirements for employer nonelective contributions invested in employer securities*—(1) *General rule.* With respect to any individual described in paragraph (c)(2) of this section, if a portion of the individual's account under an applicable defined contribution plan attributable to employer nonelective contributions is invested in employer securities, then the plan satisfies the requirements of this paragraph (c) if the individual may elect to divest those employer securities and reinvest an equivalent amount in other investment options. The plan may limit the time for divestment and reinvestment to periodic, reasonable opportunities occurring no less frequently than quarterly.

(2) *Applicable individual with respect to employer nonelective contributions.* An individual is described in this paragraph (c)(2) if the individual is—

(i) A participant who has completed at least three years of service;

(ii) An alternate payee who has an account under the plan with respect to a participant who has completed at least three years of service; or

(iii) A beneficiary of a deceased participant.

(3) *Completion of three years of service.* For purposes of paragraph (c)(2) of this section, a participant completes three years of service on the last day of the vesting computation period provided for under the plan that constitutes the completion of the third year of service under section 411(a)(5). However, for a plan that uses the elapsed time method of crediting service for vesting purposes (or a plan that provides for immediate vesting without using a vesting computation period or the elapsed time method of determining vesting), a participant completes three years of service on the day immediately preceding the third anniversary of the participant's date of hire.

(d) *Investment options.* An applicable defined contribution plan must offer not less than three investment options, other than employer securities, to which an individual who has the right to divest under paragraph (b)(1) or (c)(1) of this section may direct the proceeds from the divestment of employer securities. Each of the three investment options must be diversified and have materially different risk and return characteristics. For this purpose, investment options that constitute a broad range of investment alternatives within the meaning of Department of Labor Regulation section 2550.404c–1(b)(3) are treated as being diversified and having materially different risk and return characteristics.

(e) *Restrictions or conditions on investments in employer securities*—(1) *Impermissible restrictions or conditions*—(i) *General rule.* Except as provided in paragraph (e)(2) of this section, an applicable defined contribution plan violates the requirements of this paragraph (e) if the plan imposes restrictions or conditions with respect to the investment of employer securities that are not imposed on the investment of other assets of the plan. A restriction or condition with respect to employer securities means—

(A) A restriction on an individual's right to divest an investment in employer securities that is not imposed on an investment that is not employer securities; or

(B) A benefit that is conditioned on investment in employer securities.

(ii) *Indirect restrictions or conditions*—(A) Except as provided in paragraph (e)(3) of this section, a plan violates the requirements of this paragraph (e) if the plan imposes a restriction or condition described in paragraph (e)(1)(i)(A) or (B) of this section either directly or indirectly.

(B) A plan imposes an indirect restriction on an individual's right to divest an investment in employer securities if, for example, the plan provides that a participant who divests his or her account balance with respect to the investment in employer securities is not permitted for a period of time thereafter to reinvest in employer securities.

(C) A plan does not impose an indirect restriction or condition merely because there are tax consequences that result from an individual's divestment of an investment in employer securities. Thus, the loss of the special treatment for net unrealized appreciation provided

under section 402(e)(4) with respect to employer securities is disregarded. Similarly, a plan does not impose an impermissible restriction or condition merely because it provides that an individual may not reinvest divested amounts in the same employer securities account but is permitted to invest such divested amounts in another employer securities account where the only relevant difference between the separate accounts is the section 402(e)(4) cost (or other basis) of the trust in the shares held in each account. (See § 1.402(a)–1(b) for rules regarding section 402(e)(4).)

(2) *Permitted restrictions or conditions*—(i) *In general.* An applicable defined contribution plan does not violate the requirements of this paragraph (e) merely because it imposes a restriction or a condition set forth in paragraph (e)(2)(ii) or (e)(2)(iii) of this section.

(ii) *Securities laws.* A plan is permitted to impose a restriction or condition on the divestiture of employer securities that is either required in order to ensure compliance with applicable securities laws or is reasonably designed to ensure compliance with applicable securities laws. For example, it is permissible for a plan to limit divestiture rights for participants who are subject to section 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78f) to a reasonable period (such as 3 to 12 days) following publication of the employer's quarterly earnings statements because it is reasonably designed to ensure compliance with Rule 10b–5 of the Securities and Exchange Commission.

(iii) *Deferred application of the diversification requirements*—(A) *Becoming an applicable defined contribution plan.* An applicable defined contribution plan is permitted to restrict the application of the diversification requirements of section 401(a)(35) and this section for up to 90 days after the plan becomes an applicable defined contribution plan (for example, a plan becoming an applicable defined contribution plan because the employer securities held under the plan become publicly traded).

(B) *Loss of exception for indirect investments.* In the case where an investment fund described in paragraph (f)(3)(ii)(A) of this section no longer meets the requirement in paragraph (f)(3)(ii)(B) of this section that the investment must be independent of the employer (including the situation where the fund no longer meets the percentage limitation rule in paragraph (f)(3)(ii)(C) of this section), the plan does not fail to satisfy the diversification requirements of section 401(a)(35) and this section merely because it does not offer those rights with respect to that investment fund for up to 90 days after the investment fund ceases to meet those requirements.

(3) *Permitted indirect restrictions or conditions*—(i) *In general.* An applicable defined contribution plan does not violate the requirements of this paragraph (e) merely because it imposes an indirect restriction or condition set forth in this paragraph (e)(3).

(ii) *Limitation on investment in employer securities.* A plan is permitted to limit the extent to which an individual's account balance can be invested in employer securities, provided the limitation applies without regard to a prior exercise of rights to divest employer securities. For example, a plan does not impose a restriction that violates this paragraph (e) merely because the plan prohibits a participant from investing additional amounts in employer securities if more than 10 percent of that participant's account balance is invested in employer securities.

(iii) *Trading frequency.* A plan is permitted to impose reasonable restrictions on the timing and number of investment elections that an individual can make to invest in employer securities, provided that the restrictions are designed to limit short-term trading in the employer securities. For example, a plan could provide that a participant may not elect to invest in employer securities if the employee has elected to divest employer securities within a short period of time, such as seven days, prior to the election to invest in employer securities.

(iv) *Fees.* The plan has not provided an indirect benefit that is conditioned on investment in employer securities merely because the plan imposes fees on other investment options that are not imposed on the investment in employer securities. In addition, the plan has not provided a restriction on the right to divest an investment in employer securities merely because the plan imposes a reasonable fee for the divestment of employer securities.

(v) *Stable value or similar fund.* A plan is permitted to allow transfers to be made into or out of a stable value or similar fund more frequently than a fund invested in employer securities for purposes of paragraph (e)(1)(ii) of this section. Thus, a plan that includes a broad range of investment alternatives as described in paragraph (d) of this section, including a stable value or similar fund, does not impose an impermissible restriction under paragraph (e)(1)(ii) of this section merely because it permits transfers into or out of that fund more frequently than other funds under the plan, provided that the plan would otherwise satisfy this paragraph (e) (taking into account any restrictions or conditions imposed with respect to the other investment options under the plan). For purposes of this section, a stable value fund or similar fund means an investment product or fund designed to preserve or guarantee principal and provide a reasonable rate of return, while providing liquidity for benefit distributions or transfers to other investment alternatives (such as a product or fund described in Department of Labor Regulation § 2550.404c–5(e)(4)(iv)(A) or (v)(A)).

(vi) *Transfers out of a qualified default investment alternative (QDIA).* A plan is permitted to provide for transfers out of a QDIA within the meaning of Department of Labor Regulation section 2550.404c–5(e) more frequently than a fund invested in employer securities.

(vii) *Frozen funds*—(A) *General rule.* A plan is permitted to prohibit any further investment in employer securities. Thus, a plan is not treated as imposing an indirect restriction merely because it provides that an employee that divests an investment in employer securities is not permitted to reinvest in employer securities, but only if the plan does not permit additional contributions or other investments to be invested in employer securities. For this purpose, a plan does not provide for further investment in employer securities merely because dividends paid on employer securities under the plan are reinvested in employer securities.

(B) *Transitional relief for certain leveraged employee stock ownership plans (ESOPs).* An employer stock fund does not fail to be a frozen fund under this paragraph (e)(3)(vii) merely because of the allocation of employer securities that are released as matching contributions from the plan's suspense account that holds employer securities acquired with an exempt loan under section 4975(d)(3). This paragraph (e)(3)(vii)(B) only applies to employer securities that were acquired in a plan year beginning before January 1, 2007, with the proceeds of an exempt loan within the meaning of section 4975(d)(3) which is not refinanced after the end of the last plan year beginning before January 1, 2007.

(4) *Delegation of authority to Commissioner.* The Commissioner may provide for additional permitted restrictions or conditions or permitted indirect restrictions or conditions in revenue rulings, notices, or other

guidance published in the Internal Revenue Bulletin.

(f) *Definitions*—(1) *Application of definitions.* This paragraph (f) contains definitions that are applicable for purposes of this section.

(2) *Applicable defined contribution plan*—(i) *General rule.* Except as provided in this paragraph (f)(2), an applicable defined contribution plan means any defined contribution plan which holds employer securities that are publicly traded. See paragraph (f)(2)(iv) of this section for a special rule that treats certain plans that hold employer securities that are not publicly traded as applicable defined contribution plans and paragraph (f)(3)(ii) of this section for a special rule that treats certain plans as not holding publicly traded employer securities for purposes of this section.

(ii) *Exception for certain ESOPs.* An employee stock ownership plan (ESOP), as defined in section 4975(e)(7), is not an applicable defined contribution plan if the plan is a separate plan for purposes of section 414(l) with respect to any other defined benefit plan or defined contribution plan maintained by the same employer or employers and holds no contributions (or earnings thereunder) that are (or were ever) subject to section 401(k) or 401(m). Thus, an ESOP is an applicable defined contribution plan if the ESOP is a portion of a larger plan (whether or not that larger plan includes contributions that are subject to section 401(k) or 401(m)). For purposes of this paragraph (f)(2)(ii), a plan is not considered to hold amounts ever subject to section 401(k) or 401(m) merely because the plan holds amounts attributable to rollover amounts in a separate account that were previously subject to section 401(k) or 401(m).

(iii) *Exception for one-participant plans.* A one-participant plan, as defined in section 401(a)(35)(E)(iv), is not an applicable defined contribution plan.

(iv) *Certain defined contribution plans treated as holding publicly traded employer securities*—(A) *General rule.* A defined contribution plan holding employer securities that are not publicly traded is treated as an applicable defined contribution plan if any employer maintaining the plan or any member of a controlled group of corporations that includes such employer has issued a class of stock which is publicly traded. For purposes of this paragraph (f)(2)(iv), a controlled group of corporations has the meaning given such term by section 1563(a), except that "50 percent" is substituted for "80 percent" each place it appears.

(B) *Exception for certain plans.* Paragraph (f)(2)(iv)(A) of this section does not apply to a plan if—

(*1*) No employer maintaining the plan (or a parent corporation with respect to such employer) has issued stock that is publicly traded; and

(*2*) No employer maintaining the plan (or parent corporation with respect to such employer) has issued any special class of stock which grants to the holder or issuer particular rights, or bears particular risks for the holder or issuer, with respect to any employer maintaining the plan (or any member of a controlled group of corporations that includes such employer) which has issued any stock that is publicly traded.

(3) *Employer security*—(i) *General rule.* Employer security has the meaning given such term by section 407(d)(1) of the Employee Retirement Income Security Act of 1974, as amended (ERISA).

(ii) *Certain defined contribution plans or investment funds not treated as holding employer securities*—(A) *Exception for certain indirect investments.* Subject to paragraphs (f)(3)(ii)(B) and (C) of this section, a plan (and an investment option described in paragraph (d) of this section) is not treated as holding employer securities for purposes of this section to the extent the employer securities are held indirectly as part of a broader fund that is—

(*1*) A regulated investment company described in section 851(a);

(*2*) A common or collective trust fund or pooled investment fund maintained by a bank or trust company supervised by a State or a Federal agency;

(*3*) A pooled investment fund of an insurance company that is qualified to do business in a State;

(*4*) An investment fund managed by an investment manager within the meaning of section 3(38) of ERISA for a multiemployer plan; or

(*5*) Any other investment fund designated by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin.

(B) *Investment must be independent.* The exception set forth in paragraph (f)(3)(ii)(A) of this section applies only if the investment in the employer securities is held in a fund under which—

(*1*) There are stated investment objectives of the fund; and

(*2*) The investment is independent of the employer (or employers) and any affiliate thereof.

(C) *Percentage limitation rule.* For purposes of paragraph (f)(3)(ii)(B)(*2*) of this section, an investment in employer securities in a fund is not considered to be independent of the employer (or employers) and any affiliate thereof if the aggregate value of the employer securities held in the fund is in excess of 10 percent of the total value of all of the fund's investments for the plan year. The determination of whether the value of employer securities exceeds 10 percent of the total value of the fund's investments for the plan year is made as of the end of the preceding plan year. The determination can be based on the information in the latest disclosure of the fund's portfolio holdings that was filed with the Securities and Exchange Commission (SEC) in that preceding plan year.

(4) *Parent corporation.* Parent corporation has the meaning given such term by section 424(e).

(5) *Publicly traded*—(i) *In general.* A security is publicly traded if it is readily tradable on an established securities market.

(ii) *Readily tradable on an established securities market.* For purposes of this paragraph (f)(5), except as provided by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin, a security is readily tradable on an established securities market if—

(A) The security is traded on a national securities exchange that is registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f); or

(B) The security is traded on a foreign national securities exchange that is officially recognized, sanctioned, or supervised by a governmental authority and the security is deemed by the SEC as having a "ready market" under SEC Rule 15c3–1 (17 CFR 240.15c3–1).

(g) *Applicability date and transition rules*—(1) *Statutory effective date*—(i) *General rule.* Except as otherwise provided in this paragraph (g) and section 901(c)(3)(A) and (B) of the Pension Protection Act of 2006, Public Law 109–280 (120 Stat. 780 (2006)) (PPA '06), section 401(a)(35) is effective for plan years beginning after December 31, 2006.

(ii) *Collectively bargained plans*—(A) *Delayed statutory effective date.* In the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified on or before August 17, 2006, section 401(a)(35) is effective for plan years beginning after the earlier of—

(*1*) The later of—

(*i*) December 31, 2007; or

(*ii*) The date on which the last such collective bargaining agreement

terminates (determined without regard to any extension thereof); or

(*2*) December 31, 2008.

(B) *Treatment of plans with both collectively bargained and non-collectively bargained employees.* If a collective bargaining agreement applies to some, but not all, of the plan participants, the definition of whether the plan is considered a collectively bargained plan for purposes of this paragraph (g)(1)(ii) is made in the same manner as the definition of whether a plan is collectively bargained under section 436(f)(3).

(2) *Regulatory effective/applicability date.* This section is effective and applicable for plan years beginning on or after January 1, 2011.

(3) *Statutory transition rules*—(i) *General rule.* Pursuant to section 401(a)(35)(H), in the case of the portion of an account to which paragraph (c) of this section applies and that consists of employer securities acquired in a plan year beginning before January 1, 2007, the requirements of paragraph (c) of this section only apply to the applicable percentage of such securities.

(ii) *Applicable percentage*—(A) *Phase-in percentage.* For purposes of this paragraph (g)(3), the applicable percentage is determined as follows—

Plan year to which paragraph (c) of this section applies:	The applicable percentage is:
1st	33
2nd	66
3rd and following	100

(B) *Special rule.* For a plan for which the special effective date under section 901(c)(3) of PPA '06 applies, the applicable percentage under this paragraph (g)(3)(ii) is determined without regard to the delayed effective date in section 901(c)(3)(A) and (B) of PPA '06.

(iii) *Nonapplication for participants age 55 with three years of service.* Paragraph (g)(3)(i) of this section does not apply to an individual who is a participant who attained age 55 and had completed at least three years of service (as defined in paragraph (c)(3) of this section) before the first day of the first plan year beginning after December 31, 2005.

(iv) *Separate application by class of securities.* This paragraph (g)(3) applies separately with respect to each class of securities.

Steven T. Miller,

Deputy Commissioner for Services and Enforcement.

Approved: May 5, 2010.

Michael F. Mundaca,

Assistant Secretary of the Treasury (Tax Policy).

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9483]

RIN 1545–BH65

Qualified Nonpersonal Use Vehicles

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to qualified nonpersonal use vehicles as defined in section 274(i). Qualified nonpersonal use vehicles are excepted from the substantiation requirements of section 274(d)(4) that apply to listed property as defined in section 280F(d)(4). These final regulations add clearly marked public safety officer vehicles as a new type of qualified nonpersonal use vehicle. These final regulations affect employers that provide their employees with qualified nonpersonal use vehicles and the employees who use such vehicles.

DATES: *Effective Date:* These regulations are effective on *May 19, 2010.*

Applicability Date: These regulations apply to uses of clearly marked public safety officer vehicles occurring after May 19, 2010.

FOR FURTHER INFORMATION CONTACT: Don Parkinson at (202) 622–6040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final Income Tax Regulations under section 274(i) added by section 2(b) of Public Law 99–44 (May 24, 1985), which provides a definition of qualified nonpersonal use vehicle. Temporary Regulation § 1.274–5T(k), identifying categories of qualified nonpersonal use vehicles and Temporary Regulation § 1.274–5T(l), providing for definitions of the terms "automobile," "vehicle," "employer," "employee," and "personal use" were issued in 1985. (TD 8061 1982–5 CB 93 (1985)). A notice of proposed rulemaking was issued by cross-reference to Temporary Regulation § 1.274–5T(k). (LR–145–84, 50 FR 46088, 1985–2 CB 809 (1985)).

On June 9, 2008, proposed regulations (REG–106897–08) were published in the **Federal Register** (73 FR 32500). The proposed regulations incorporated the text of § 1.274–5T(k) and added clearly marked public safety officer vehicles as a new type of qualified nonpersonal use vehicle, listed along with clearly marked police and fire vehicles at § 1.274–5(k)(2)(ii)(A). A definition of clearly marked public safety officer vehicles was added to the provision defining clearly marked police and fire vehicles at § 1.274–5(k)(3), and an example illustrating application of the rules to a public safety officer vehicle was added at § 1.274–5(k)(8) *Example 3.* The proposed regulations incorporated the text of § 1.274–5T(l) with no changes. The corresponding provisions of the proposed regulations in LR–145–84 were withdrawn on June 8, 2008.

Written public comments on the proposed regulations at § 1.274–5(k) and (l) were received and no hearing was requested. After consideration of all the comments, these final regulations adopt the provisions of the proposed regulations with an amendment to *Example 3* and the provision of a new *Example 4* in § 1.274–5(k)(8) which are intended to assist taxpayers in determining whether individual employees meet the definition of public safety officer. The temporary regulations at § 1.274–5T(k) and (l) are withdrawn concurrently with the publication of these final regulations in the **Federal Register.** The remaining temporary regulations at § 1.274–5T are unaffected by this Treasury decision.

Summary of Comments and Explanation of Provisions

Section 274(d) provides that a taxpayer is not allowed a deduction or credit for certain expenses unless the expenses are substantiated. These substantiation requirements apply to expenses incurred in the of use of any listed property (defined in section 280F(d)(4)), which includes any passenger automobile and any other property used as a means of transportation. Section 274(d) does not apply to any qualified nonpersonal use vehicle as defined in section 274(i). Both business and personal use of a vehicle that meets the criteria to be a qualified nonpersonal use vehicle under section 274(i) will also qualify as a working condition fringe benefit that is excluded from the recipient's income