Internal Revenue
bulletin

Bulletin No. 2004-16
April 19, 2004

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

REG–121475–03, page 793.

Proposed regulations under section 1397E of the Code amend the final regulations regarding qualified zone academy bonds (QZABs). The proposed regulations contain guidance for state and local governments that issue QZABs and for banks, insurance companies, and other taxpayers that hold those bonds on the maximum term, use of proceeds, and remedial actions for QZABs. A public hearing is scheduled for July 21, 2004.

Notice 2004–28, page 783.

Frivolous claims for refunds of income or alternative minimum tax incurred upon the exercise of compensatory stock options. This notice describes five claims and explains that in most cases the arguments behind such claims are without merit and will not be respected by the Service. This notice also enumerates the penalties which may be applicable to taxpayers relying on such claims or arguments.

EMPLOYEE PLANS

Ct. D. 2078, page 773.

Employee Retirement Income Security Act of 1974 (ERISA); participant; working owner. The Supreme Court holds that the working owner of a business may qualify as a "participant" in a pension plan covered by ERISA if the plan covers one or more employees other than the business owner and his or her spouse. **Raymond B. Yates, M.D., P.C. Profit Sharing Plan *et al.* v. Hendon, Trustee.**

REG–128309–03, page 800.

Proposed regulations under section 411(d)(6) of the Code provide guidance on the conditions under which a plan amendment may eliminate or reduce an early retirement benefit, a retirement-type subsidy, or an optional form of benefit with respect to a participant's benefits attributable to service before the plan amendment. The regulations also provide guidance on how the notice requirements of section 4980F apply with respect to such plan amendments. A public hearing is scheduled for June 24, 2004.

Rev. Proc. 2004–25, page 791.

Remedial amendment period; disqualifying provisions; December 31, 2001. This procedure extends the remedial amendment period under section 401(b) of the Code with respect to certain disqualifying provisions of all new plans put into effect after December 31, 2001, until the end of the remedial amendment period for the Economic Growth and Tax Relief Reconciliation Act of 2001.

EXEMPT ORGANIZATIONS

Announcement 2004–28, page 818.

A list is provided of organizations now classified as private foundations.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

ADMINISTRATIVE

Notice 2004–26, page 782.

Public comments are requested for items that should be included on the 2004–2005 Guidance Priority List. Taxpayers may submit recommendations at any time during the year. All recommendations received by April 30, 2004, will be reviewed for possible inclusion on the original 2004–2005 Guidance Priority List. Recommendations received after April 30, 2004, will be reviewed for inclusion in the quarterly updates if received by August 31, 2004; November 30, 2004; or February 28, 2005, respectively.

Notice 2004–27, page 782.

Losses; decrease in stock value. This notice advises taxpayers that the Service will disallow deductions for theft losses claimed on account of decreases in the market value of stock purchased on the open market that may be attributable to fraudulent misrepresentations or other illegal misconduct of corporate officials. A taxpayer generally may deduct as a capital loss such a decrease in value when it is recognized by the taxpayer because the stock is sold or exchanged or becomes wholly worthless.

Rev. Proc. 2004–23, page 785.

This document provides administrative procedures under which taxpayers may obtain automatic consent to change to a method of accounting provided in sections 1.263(a)–4, 1.263(a)–5, and 1.167(a)–3(b) of the regulations for the taxpayer's first taxable year ending on or after December 31, 2003. Rev. Proc. 2002–9 modified and amplified. Announcement 93–60 obsoleted.

Rev. Proc. 2004–24, page 790.

Qualified mortgage bonds; mortgage credit certificates; national median gross income. Guidance is provided concerning the use of the national and area median gross income figures by issuers of qualified mortgage bonds and mortgage credit certificates in determining the housing cost/income ratio described in section 143(f) of the Code. Rev. Proc. 2003–29, obsoleted, except as provided in section 5.02 of this procedure.

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

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Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 56.—Adjustments in Computing Alternative Minimum Taxable Income

A notice describes the frivolous nature of certain refund claims arising from the exercise of compensatory stock options. See Notice 2004-28, page 783.

Section 83.—Property Transferred in Connection With Performance of Services

A notice describes the frivolous nature of certain refund claims arising from the exercise of compensatory stock options. See Notice 2004-28, page 783.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401(b)–1: Certain retroactive changes in plan.

A revenue procedure extends the remedial amendment period under § 401(b) of the Code with respect to certain disqualifying provisions of all new plans put into effect after December 31, 2001, to the end of the remedial amendment period for the Economic Growth and Tax Relief Reconciliation Act of 2001. See Rev. Proc. 2004-25, page 791.

Ct. D. 2078

SUPREME COURT OF THE UNITED STATES

No. 02-458

RAYMOND B. YATES, M.D., P.C. PROFIT SHARING PLAN ET AL. *v.* HENDON, TRUSTEE

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

March 2, 2004

Syllabus

Enacted "to protect . . . the interests of participants in employee benefit plans and their beneficiaries," 29 U.S.C. Sec. 1001(b), the Employee Retirement Income Security Act of 1974 (ERISA) comprises four titles. Relevant here, Title I, 29 U.S.C. Sec. 1001 *et seq.*, mandates minimum participation, vesting, and funding schedules for covered pension plans, and establishes fiduciary conduct standards for plan administrators. Title II, codified in 26 U.S.C., amended various Internal Revenue Code (IRC) provisions pertaining to qualification of pension plans for special tax treatment, in order, *inter alia*, to conform to Title I's standards. Title III, 29 U.S.C. Sec. 1201 *et seq.*, contains provisions designed to coordinate enforcement efforts of different federal departments. Title IV, 29 U.S.C. Sec. 1301 *et seq.*, created the Pension Benefit Guaranty Corporation and an insurance program to protect employees against the loss of "nonforfeitable" benefits upon termination of pension plans lacking sufficient funds to pay benefits in full. This case concerns Title I's definition and coverage provisions, though those provisions, indicating who may participate in an ERISA-sheltered plan, inform each of ERISA's four titles. Title I defines "employee benefit plan" as "an employee welfare benefit plan or an employee pension benefit plan or . . . both," Sec. 1002(3); "participant" to encompass "any employee . . . eligible to receive a benefit . . . from an employee benefit plan," Sec. 1002(7); "employee" as "any individual employed by an employer," Sec. 1002(6); and "employer" to include "any person acting . . . as an employer, or . . . in the interest of an employer," Sec. 1002(5).

Yates was sole shareholder and president of a professional corporation that maintained a profit sharing plan (Plan). From the Plan's inception at least one person other than Yates or his wife was a Plan participant. The Plan qualified for favorable tax treatment under IRC Sec. 401. As required by the IRC, 26 U.S.C. Sec. 401(a)(13), and ERISA, 29 U.S.C. Sec. 1056(d), the Plan contained an anti-alienation provision. Entitled "Spendthrift Clause," the provision stated in relevant part: "Except for . . . loans to Participants as [expressly provided for in the Plan], no benefit or interest available hereunder will be subject to assignment or alienation." In December, 1989, Yates borrowed $20,000 from another of his corporation's pension plans (which later merged into the Plan), but failed to make any of the required monthly payments. In November, 1996, however, Yates paid off the loan in full with the proceeds of the sale of his house. Three weeks later, Yates's creditors filed an involuntary petition against him under Chapter 7 of the Bankruptcy Code. Respondent Hendon, the Bankruptcy Trustee, filed a complaint against petitioners (the Plan and Yates, as Plan trustee), asking the Bankruptcy Court to avoid the loan repayment. Granting Hendon summary judgment, the Bankruptcy Court first determined that the repayment qualified as a preferential transfer under 11 U.S.C. Sec. 547(b). That finding was not challenged on appeal. The Bankruptcy Court then held that the Plan and Yates, as Plan trustee, could not rely on the Plan's anti-alienation provision to prevent Hendon from recovering the loan repayment for the bankruptcy estate. That holding was dictated by Sixth Circuit precedent, under which a self-employed owner of a pension plan's corporate sponsor could not "participate" as an "employee" under ERISA, and therefore could not use ERISA's provisions to enforce the restriction on transfer of his beneficial interest in the plan. The District Court and the Sixth Circuit affirmed on the same ground. The Sixth Circuit's determination that Yates was not a "participant" in the Plan for ERISA purposes obviated the question whether, had Yates qualified as such a participant, his loan repayment would have been shielded from the Bankruptcy Trustee's reach.

Held: The working owner of a business (here, the sole shareholder and president of a professional corporation) may qualify as a "participant" in a pension plan covered by ERISA. If the plan covers one or more employees other than the business owner and his or her spouse, the working owner may participate on equal terms with other plan participants. Such a working owner, in common with other employees, qualifies for the protections ERISA affords plan participants and is governed by the rights and remedies ERISA specifies. Pp. 8–20.

(a) Congress intended working owners to qualify as plan participants. Because ERISA's definitions of "employee" and, in turn, "participant" are uninformative, the Court looks to other ERISA provisions for instruction. See *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 323. ERISA's multiple textual indications that Congress intended working owners to qualify as plan participants provide, in combination, "specific guidance," *ibid*., so there is no cause in this case to resort to common law. ERISA's enactment in 1974 did not change the existing backdrop of IRC provisions permitting corporate shareholders, partners, and sole proprietors to participate in tax-qualified pension plans. Rather, Congress' objective was to harmonize ERISA with these longstanding tax provisions. Title I of ERISA and related IRC provisions expressly contemplate the participation of working owners in covered benefit plans. Most notably, Title I frees certain plans in which working owners likely participate from all of ERISA's fiduciary responsibility requirements. See 29 U.S.C. Sec. 1101(a) and 26 U.S.C. Secs. 414(q)(1)(A) and 416(i)(1)(B)(i). Title I also contains more limited exemptions from ERISA's fiduciary responsibility requirements for plans that ordinarily include working owners as participants. See 29 U.S.C. Secs. 1103(a) and (b)(3)(A) and 26 U.S.C. Secs. 401(c)(1) and (2)(A)(i), 1402(a) and (c). Further, Title I contains exemptions from ERISA's prohibited transaction exemptions, which, like the fiduciary responsibility exemptions, indicate that working owners may participate in ERISA-qualified plans. See 29 U.S.C. Secs. 1108(b)(1)(B) and (d)(1) and 26 U.S.C. Sec. 401(c)(3). Exemptions of this order would be unnecessary if working owners could not qualify as participants in ERISA-protected plans in the first place. Provisions of Title IV of ERISA are corroborative. For example, Title IV does not apply to plans "established and maintained *exclusively* for substantial owners," Sec. 1321(b)(9) (emphasis added), a category that includes sole proprietors and shareholders and partners with a ten percent or greater ownership interest, Sec. 1322(b)(5)(A). But Title IV does cover plans in which substantial owners participate *along with* other employees. See Sec. 1322(b)(5)(B). Particularly instructive, Title IV and the IRC, as amended by Title II, clarify a key point missed by several lower courts: Under ERISA, a working owner may wear two hats, *i.e.*, he can be an employee entitled to participate in a plan and, at the same time, the employer who established the plan. See Sec. 1301(b)(1) and 26 U.S.C. Sec. 401(c)(4). Congress' aim to promote and facilitate employee benefit plans is advanced by the Court's reading of ERISA's text. The working employer's opportunity personally to participate and gain ERISA coverage serves as an incentive to the creation of plans that will benefit employer and nonowner employees alike. Treating the working owner as a participant in an ERISA-sheltered plan also avoids the anomaly that the same plan will be controlled by discrete regimes: federal-law governance for the nonowner employees; state-law governance for the working owner. Excepting working owners from ERISA's coverage is hardly consistent with the statutory goal of "uniform national treatment of pension benefits," *Patterson v. Shumate*, 504 U.S. 753, 765, and would generate administrative difficulties. A 1999 Department of Labor advisory opinion (hereinafter Advisory Opinion 99–04A) accords with the Court's comprehension of Title I's definition and coverage provisions. Concluding that working owners may qualify as participants in ERISA-protected plans, the Department's opinion reflects a "body of experience and informed judgment to which courts and litigants may properly resort for guidance." *Skidmore v. Swift & Co*., 323 U.S. 134, 140. Pp. 8–14.

(b) This Court rejects the lower courts' position that a working owner may rank only as an "employer," and not also as an "employee" for purposes of ERISA-sheltered plan participation. The Sixth Circuit's leading decision in point relied, in large part, on an incorrect reading of a portion of a Department of Labor regulation, 29 CFR Sec. 2510.3–3, which states: "[T]he term 'employee benefit plan' [as used in Title I] shall not include any plan . . . under which no employees are participants"; "*[f]or purposes of this section*," "an individual and his or her spouse shall not be deemed to be employees with respect to a . . . business" they own. (Emphasis added.) In common with other Courts of Appeals that have held working owners do not qualify as participants in ERISA-governed plans, the Sixth Circuit apparently understood the regulation to provide a generally applicable definition of "employee," controlling for all Title I purposes. The Labor Department's Advisory Opinion 99–04A, however, interprets the regulation to mean that the statutory term "employee benefit plan" does not include a plan whose *only* participants are the owner and his or her spouse, but does include a plan that covers as participants one or more common-law employees, in addition to the self-employed individuals. This agency view, overlooked by the Sixth Circuit, merits the Judiciary's respectful consideration. *Cf. Clackamas Gastroenterology Assoc., P.C.*, 538 U.S. at _____. Moreover, the Department's regulation itself reveals the definitional prescription's limited scope. The prescription describes "employees" only "[f]or purposes of this section," *i.e.*, the section defining "employee benefit plans." Accordingly, the regulation addresses only what plans qualify as "employee benefit plans" under ERISA's Title I. Plans that cover only sole owners or partners and their spouses, the regulation instructs, fall outside Title I's domain, while plans that cover working owners *and* their nonowner employees fall entirely within ERISA's compass. The Sixth Circuit's leading decision also mistakenly relied on ERISA's "anti-inurement" provision, 29 U.S.C. Sec. 1103(c)(1), which states that plan assets shall not inure to the benefit of employers. Correctly read, that provision does not preclude Title I coverage of working owners as plan participants. It demands only that plan assets be held to supply benefits to plan participants. Its purpose is to apply the law of trusts to discourage abuses such as self-dealing, imprudent investment, and misappropriation of plan assets, by employers and others. Those concerns are not implicated by paying benefits to working owners who participate on an equal basis with nonowner employees in ERISA-protected plans. This Court expresses no opinion as to whether Yates himself, in his handling of loan repayments, engaged in conduct inconsistent with the anti-inurement provision, an issue not yet reached by the courts below. Pp. 14–20.

(c) Given the undisputed fact that Yates failed to honor his loan's periodic repayment requirements, these questions should be addressed on remand: (1) Did

the November 1996 close-to-bankruptcy repayments, despite the prior defaults, become a portion of Yates's interest in the Plan that is excluded from his bankruptcy estate and (2) if so, were the repayments beyond the reach of the Bankruptcy Trustee's power to avoid and recover preferential transfers? P. 20.

287 F.3d 521, reversed and remanded.

GINSBURG, J., delivered the opinion of the Court, in which REHNQUIST, C. J., and STEVENS, O'CONNOR, KENNEDY, SOUTER, and BREYER, JJ., joined. SCALIA, J., and THOMAS, J., each filed an opinion concurring in the judgment.

SUPREME COURT OF THE UNITED STATES

No. 02-458

RAYMOND B. YATES, M.D., P.C. PROFIT SHARING PLAN, AND RAYMOND B. YATES, TRUSTEE, PETITIONERS *v.* WILLIAM T. HENDON, TRUSTEE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

March 2, 2004

JUSTICE GINSBURG delivered the opinion of the Court.

This case presents a question on which federal courts have divided: Does the working owner of a business (here, the sole shareholder and president of a professional corporation) qualify as a "participant" in a pension plan covered by the Employee Retirement Income Security Act of 1974 (ERISA or Act), 88 Stat. 832, as amended, 29 U.S.C. Sec. 1001 *et seq.* The answer, we hold, is yes: If the plan covers one or more employees other than the business owner and his or her spouse, the working owner may participate on equal terms with other plan participants. Such a working owner, in common with other employees, qualifies for the protections ERISA affords plan participants and is governed by the rights and remedies ERISA specifies. In so ruling, we reject the position, taken by the lower courts in this case, that a business owner may rank only as an "employer," and not also as an "employee" for purposes of ERISA-sheltered plan participation.

I

A

Enacted "to protect . . . the interests of participants in employee benefit plans and their beneficiaries," 29 U.S.C. Sec. 1001(b), ERISA comprises four titles. Title I, 29 U.S.C. Sec. 1001 *et seq.*, "requires administrators of all covered pension plans to file periodic reports with the Secretary of Labor, mandates minimum participation, vesting and funding schedules, establishes standards of fiduciary conduct for plan administrators, and provides for civil and criminal enforcement of the Act." *Nachman Corp. v. Pension Benefit Guaranty Corporation*, 446 U.S. 359, 361, n. 1 (1980). Title II, codified in various parts of Title 26 of the United States Code, "amended various [Internal Revenue Code] provisions . . . pertaining to qualification of pension plans for special tax treatment, in order, among other things, to conform to the standards set forth in Title I." 446 U.S., at 361, n. 1. Title III, 29 U.S.C. Sec. 1201 *et seq.*, "contains provisions designed to coordinate enforcement efforts of different federal departments, and provides for further study of [benefit plans]." 446 U.S., at 361, n. 1. Title IV, 29 U.S.C. Sec. 1301 *et seq.*, "created the Pension Benefit Guaranty Corporation (PBGC) and a termination insurance program to protect employees against the loss of 'nonforfeitable' benefits upon termination of pension plans that lack sufficient funds to pay such benefits in full." 446 U.S., at 361, n. 1. See also *Mead Corp. v. Tilley*, 490 U.S. 714, 717 (1989); Brief for United States as *Amicus Curiae 2*.

This case concerns the definition and coverage provisions of Title I, though those provisions, indicating who may participate in an ERISA-sheltered plan, inform each of ERISA's four titles. Title I defines the term "employee benefit plan" to encompass "an employee welfare benefit plan or an employee pension benefit plan or a plan which is both. . . ." 29 U.S.C. Sec. 1002(3). The same omnibus section defines "participant" as "any employee or former employee of an employer, . . . who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer . . ., or whose beneficiaries may be eligible to receive any such benefit." Sec. 1002(7). "Employee," under Title I's definition section, means "any individual employed by an employer," Sec. 1002(6), and "employer" includes "any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan," Sec. 1002(5).

B

Dr. Raymond B. Yates was the sole shareholder and president of Raymond B. Yates, M.D., P.C., a professional corporation. 287 F.3d 521, 524 (CA6 2002); App. to Pet. for Cert. 10a. The corporation maintained the Raymond B. Yates, M.D., P.C. Profit Sharing Plan (Profit Sharing Plan or Plan), for which Yates was the administrator and trustee. *Ibid*. From the Profit Sharing Plan's inception, at least one person other than Yates or his wife was a participant. *Ibid*.; App. 269a. The Profit Sharing Plan qualified for favorable tax treatment under Sec. 401 of the Internal Revenue Code (IRC). 287 F.3d at 524; App. 71a–73a. As required by both the IRC, 26 U.S.C. Sec. 401(a)(13), and Title I of ERISA, 29 U.S.C. Sec. 1056(d), the Plan contained an anti-alienation provision. That provision, entitled "Spendthrift Clause," stated in relevant part: "Except for . . . loans to Participants as [expressly provided for in the Plan], no benefit or interest available hereunder will be subject to assignment or alienation, either voluntarily or involuntarily." App. 252a.

In December 1989, Yates borrowed $20,000 at 11 percent interest from the Raymond B. Yates, M.D., P.C. Money Purchase Pension Plan (Money Purchase Pension Plan), which later merged into the Profit Sharing Plan. *Id*., at 268a–269a. The terms of the loan agreement required Yates to make monthly payments of $433.85 over the five-year period of the loan. *Id*., at 269a. Yates failed to make any monthly payment. 287 F.3d at 524. In June 1992, coinciding with the Money Purchase Pension Plan-Profit Sharing Plan merger, Yates renewed the loan for five years. App. 269a. Again, he made no

monthly payments. In fact, Yates repaid nothing until November 1996. 287 F.3d, at 524. That month, he used the proceeds from the sale of his house to make two payments totaling $50,467.46, which paid off in full the principal and interest due on the loan. *Ibid*. Yates maintained that, after the repayment, his interest in the Profit Sharing Plan amounted to about $87,000. App. to Pet. for Cert. 39a.

Three weeks after Yates repaid the loan to the Profit Sharing Plan, on December 2, 1996, Yates's creditors filed an involuntary petition against him under Chapter 7 of the Bankruptcy Code. *Id*., at 12a; accord, App. 300a. In August 1998, respondent William T. Hendon, the Bankruptcy Trustee, filed a complaint, pursuant to 11 U.S.C. Secs. 547(b) and 550, against petitioners Profit Sharing Plan and Yates, in his capacity as the Plan's trustee. App. 1a–3a. Hendon asked the Bankruptcy Court to "avoi[d] the . . . preferential transfer by [Yates] to [the Profit Sharing Plan] in the amount of $50,467.46 and [to] orde[r] [the Plan and Yates, as trustee] to pay over to the [bankruptcy] trustee the sum of $50,467.46, plus legal interest . . . , together with costs . . . ." *Id*., at 3a. On cross-motions for summary judgment, the Bankruptcy Court ruled for Trustee Hendon. App. to Pet. for Cert. 36a–50a.

The Bankruptcy Court first determined that the loan repayment qualified as a preferential transfer under 11 U.S.C. Sec. 547(b).[1] App. to Pet. for Cert. 41a–42a. That finding was not challenged on appeal. The Bankruptcy Court then held that the Profit Sharing Plan and Yates, as trustee, could not rely on the Plan's anti-alienation provision to prevent Hendon from recovering the loan repayment. As "a self-employed owner of the professional corporation that sponsor[ed] the pension plan," the Bankruptcy Court stated, Yates could not "participate as an employee under ERISA and . . . [therefore could not] use its provisions to enforce the restriction on the transfer of his beneficial interest in the Defendant Plan." *Id*., at 43a–44a. In so ruling, the Bankruptcy Court relied on Circuit precedent, including *SEC v. Johnston*, 143 F.3d 260 (CA6 1998), and *Fugarino v. Hartford Life and Accident Ins. Co*., 969 F.2d 178 (CA6 1992).

The District Court affirmed the Bankruptcy Court's judgment. App. to Pet. for Cert. 9a–35a. Acknowledging that other Courts of Appeals had reached a different conclusion, *id*., at 19a, the District Court observed that it was bound by Sixth Circuit precedent. According to the controlling Sixth Circuit decisions, neither a sole proprietor, *Fugarino*, 969 F.2d at 186, nor a sole owner of a corporation, *Agrawal v. Paul Revere Life Ins. Co*., 205 F.3d 297, 302 (2000), qualifies as a "participant" in an ERISA-sheltered employee benefit plan. App. to Pet. for Cert. 20a–21a. Applying Circuit precedent, the District Court concluded:

> "The fact Dr. Yates was not qualified to participate in an ERISA protected plan means none of the money he contributed to the Plan as an 'employee' was ever part of an ERISA plan. The $50,467.46 he returned to the Plan was not protected by ERISA, because none of the money he had in the Plan was protected by ERISA." *Id*., at 20a.

The Sixth Circuit affirmed the District Court's judgment. 287 F.3d 521. The Court of Appeals adhered to its "published caselaw [holding] that 'a sole proprietor or sole shareholder of a business must be considered an employer and not an employee . . . for purposes of ERISA.'" *Id*., at 525 (quoting *Fugarino*, 969 F.2d at 186). "[T]he spendthrift clause in the Yates profit sharing/pension plan," the appeals court accordingly ruled, "[was] not enforceable by Dr. Yates under ERISA." 287 F.3d at 526. The Sixth Circuit's determination that Yates was not a "participant" in the Profit Sharing Plan for ERISA purposes obviated the question whether, had Yates qualified as such a participant, his loan repayment would have been shielded from the Bankruptcy Trustee's reach. See App. to Pet. for Cert. 46a–47a.

We granted certiorari, 539 U.S. — (2003), in view of the division of opinion among the Circuits on the question whether a working owner may qualify as a participant in an employee benefit plan covered by ERISA. Compare *Agrawal*, 205 F.3d, at 302 (sole shareholder is not a participant in an ERISA-qualified plan); *Fugarino*, 969 F.2d, at 186 (sole proprietor is not a participant); *Kwatcher v. Massachusetts Serv. Employees Pension Fund*, 879 F.2d 957, 963 (CA1 1989) (sole shareholder is not a participant); *Giardono v. Jones*, 867 F.2d 409, 411–412 (CA7 1989) (sole proprietor is not a participant); *Peckham v. Board of Trustees of Int'l Brotherhood of Painters and Allied Trades Union*, 653 F.2d 424, 427–428 (CA10 1981) (sole proprietor is not a participant), with *Vega v. National Life Ins. Servs., Inc*., 188 F.3d 287, 294 (CA5 1999) (co-owner is a participant); *In re Baker*, 114 F.3d 636, 639 (CA7 1997) (majority shareholder is a participant); *Madonia v. Blue Cross & Blue Shield of Virginia*, 11 F.3d 444, 450

[1] Subsection 547(b) provides:

"Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property —

"(1) to or for the benefit of a creditor;

"(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

"(3) made while the debtor was insolvent;

"(4) made —

"(A) on or within 90 days before the date of the filing of the petition; or

"(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

"(5) that enables such creditor to receive more than such creditor would receive if –

"(A) the case were a case under chapter 7 of this title;

"(B) the transfer had not been made; and

"(C) such creditor received payment of such debt to the extent provided by the provisions of this title."

This provision permits the bankruptcy trustee to avoid certain transfers of "property that would have been part of the [bankruptcy] estate had it not been transferred before the commencement of bankruptcy proceedings." *Begier v. IRS*, 496 U.S. 53, 58 (1990).

(CA4 1993) (sole shareholder is a participant).[2]

II

A

ERISA's definitions of "employee," and, in turn, "participant" are uninformative. See *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 323 (1992) ("ERISA's nominal definition of 'employee' as 'any individual employed by an employer,' is completely circular and explains nothing." (citation omitted)). We therefore look to other provisions of the Act for instruction. See *ibid*. ERISA's text contains multiple indications that Congress intended working owners to qualify as plan participants. Because these indications combine to provide "specific guidance," *ibid*., there is no cause in this case to resort to common law.[3]

Congress enacted ERISA against a backdrop of IRC provisions that permitted corporate shareholders, partners, and sole proprietors to participate in tax-qualified pension plans. Brief for United States as *Amicus Curiae* 19–20. Working shareholders have been eligible to participate in such plans since 1942. See Revenue Act of 1942, ch. 619, Sec. 165(a)(4), 56 Stat. 862 (a pension plan shall be tax-exempt if, *inter alia*, "the contributions or benefits provided under the plan do not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees"). Two decades later, still prior to ERISA's adoption, Congress permitted partners and sole proprietors to establish tax-favored pension plans, commonly known as "H.R. 10" or "Keogh" plans. Self-Employed Individuals Tax Retirement Act of 1962, 76 Stat. 809; Brief for United States as *Amicus Curiae* 19. Thus, by 1962, working owners of all kinds could contribute to tax-qualified retirement plans.

ERISA's enactment in 1974 did not change that situation.[4] Rather, Congress' objective was to harmonize ERISA with longstanding tax provisions. Title I of ERISA and related IRC provisions expressly contemplate the participation of working owners in covered benefit plans. *Id*., at 14–16. Most notably, several Title I provisions partially exempt certain plans in which working owners likely participate from otherwise mandatory ERISA provisions. Exemptions of this order would be unnecessary if working owners could not qualify as participants in ERISA-protected plans in the first place.

To illustrate, Title I frees the following plans from the Act's fiduciary responsibility requirements:

> "(1) a plan which is unfunded and is maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees;" or
>
> "(2) any agreement described in section 736 of [the IRC], which provides payments to a retired partner or deceased partner or a deceased partner's successor in interest." 29 U.S.C. Sec. 1101(a).

The IRC defines the term "highly compensated employee" to include "any employee who . . . was a 5-percent owner at any time during the year or the preceding year." 26 U.S.C. Sec. 414(q)(1)(A). A "5-percent owner," the IRC further specifies, is "any person who owns . . . more than 5 percent of the outstanding stock of the corporation or stock possessing more than 5 percent of the total combined voting power of all stock of the corporation" if the employer is a corporation, or "any person who owns more than 5 percent of the capital or profits interest in the employer" if the employer is not a corporation. Sec. 416(i)(1)(B)(i). Under these definitions, some working owners would fit the description "highly compensated employees." Similarly, agreements that make payments to retired partners, or to deceased partners' successors in interest, surely involve plans in which working partners participate.

Title I also contains more limited exemptions from ERISA's fiduciary responsibility requirements. These exemptions, too, cover plans that ordinarily include working owners as participants. To illustrate, assets of an employee benefit plan typically must be held in trust. See 29 U.S.C. Sec. 1103(a). That requirement, however, does not apply, *inter alia*, "to a plan . . . some or all of the participants of which are employees described in section 401(c)(1) of [the IRC]." 29 U.S.C. Sec. 1103(b)(3)(A). IRC Sec. 401(c)(1)(A) defines an "employee" to include "a self-employed individual"; and IRC Secs. 401(c)(1)(B) and (2)(A)(i), in turn, define "a self-employed individual" to cover an individual with "earned income" from "a trade or business in which personal services of the taxpayer are a material income-producing factor." This definition no doubt encompasses working sole proprietors and partners. 26 U.S.C. Sec. 1402(a) and (c).

Title I also contains exemptions from ERISA's prohibited transaction provisions. Like the fiduciary responsibility exemptions, these exemptions indicate that working owners may participate in ERISA-qualified plans. For example, although Title I generally bars transactions between a plan and a party in interest, 29 U.S.C. Sec. 1106, the Act permits, among other exceptions, loans to plan participants if certain conditions are satisfied, Sec. 1108(b)(1). One condition is that loans must not be "made available to highly compensated employees . . . in an amount greater than the amount made available to other employees." Sec. 1108(b)(1)(B). As just observed,

[2] The Courts of Appeals are also divided on whether working owners may qualify as "beneficiaries" of ERISA-sheltered employee benefit plans. Compare 287 F.3d 521, 525 (CA6 2002) (case below) (sole shareholder is not a beneficiary of an ERISA-qualified plan); *Agrawal*, 205 F.3d at 302 (sole shareholder is not a beneficiary), with *Gilbert v. Alta Health & Life Ins. Co*., 276 F.3d 1292, 1302 (CA11 2001) (sole shareholder is a beneficiary); *Wolk v. UNUM Life Ins. of Am*., 186 F.3d 352, 356 (CA3 1999) (partner is a beneficiary); *Prudential Ins. Co. of Am. v. Doe*, 76 F.3d 206, 208 (CA8 1996) (controlling shareholder is a beneficiary); *Robinson v. Linomaz*, 58 F.3d 365, 370 (CA8 1995) (co-owners are beneficiaries); *Peterson v. American Life & Health Ins. Co*., 48 F.3d 404, 409 (CA9 1995) (partner is a beneficiary). The United States, as *amicus curiae*, urges that treating working owners as "beneficiaries" of an ERISA-qualified plan is not an acceptable solution. Brief for United States as *Amicus Curiae 9* (The beneficiary approach "has no logical stopping point, because it would allow a plan to cover anyone it chooses, including independent contractors excluded by [*Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318 (1992)]" and "fails to resolve participation questions for pension plans which, unlike welfare plans, tie coverage directly to service as an employee."); *id*., at 24–25. This issue is not presented here, and we do not resolve it.

[3] Cf. *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318 (1992), and *Clackamas Gastroenterology Assoc., P.C. v. Wells*, 538 U.S. 440 (2003) (finding textual clues absent, Court looked to common law for guidance).

[4] A particular employee benefit plan may be covered by one title of ERISA, but not by another. See Brief for United States as *Amicus Curiae* 18, n. 9.

see *supra*, at 9–10, some working owners, including shareholder-employees, qualify as "highly compensated employees." Title I goes on to exclude "owner-employees," as defined in the IRC, from the participant loan exemption. Sec. 1108(d)(1). Under the IRC's definition, owner-employees include partners "who ow[n] more than 10 percent of either the capital interest or the profits interest in [a] partnership" and sole proprietors, but not shareholder-employees. 26 U.S.C. Sec. 401(c)(3). In sum, Title I's provisions involving loans to plan participants, by explicit inclusion or exclusion, assume that working owners — shareholder-employees, partners, and sole proprietors — may participate in ERISA-qualified benefit plans.

Provisions of Title IV of ERISA are corroborative. Brief for United States as *Amicus Curiae* 17, and n. 8. Title IV does not apply to plans "established and maintained *exclusively* for substantial owners," 29 U.S.C. Sec. 1321(b)(9) (emphasis added), a category that includes sole proprietors and shareholders and partners with a ten percent or greater ownership interest, Sec. 1322(b)(5)(A). But Title IV does cover plans in which substantial owners participate *along with* other employees. See Sec. 1322(b)(5)(B). In addition, Title IV does not cover plans established by "professional service employers" with 25 or fewer active participants. Sec. 1321(b)(13). Yates's medical practice was set up as a professional service employer. See Sec. 1321(c)(2)(A) (a "professional service employer" is "any proprietorship, partnership, corporation . . . owned or controlled by professional individuals . . . the principal business of which is the performance of professional services"). But significantly larger plans — plans covering more than 25 employees — established by a professional service employer would presumably qualify for protection.

Particularly instructive, Title IV and the IRC, as amended by Title II, clarify a key point missed by several lower courts: Under ERISA, a working owner may have dual status, *i.e.*, he can be an employee entitled to participate in a plan and, at the same time, the employer (or owner or member of the employer) who established the plan. Both Title IV and the IRC describe the "employer" of a sole proprietor or partner. See 29 U.S.C. Sec. 1301(b)(1) ("An individual who owns the entire interest in an unincorporated trade or business is treated as his own employer, and a partnership is treated as the employer of each partner who is an employee within the meaning of section 401(c)(1) of [the IRC]."); 26 U.S.C. Sec. 401(c)(4) ("An individual who owns the entire interest in an unincorporated trade or business shall be treated as his own employer. A partnership shall be treated as the employer of each partner who is an employee within the meaning of [Sec. 401(c)(1)]."). These descriptions expressly anticipate that a working owner can wear two hats, as an employer and employee. Cf. *Clackamas Gastroenterology Assoc., P.C. v. Wells*, 538 U.S. 440, — (2003) (slip op., at 2–3) (GINSBURG, J., dissenting) ("Clackamas readily acknowledges that the physician-shareholders are 'employees' for ERISA purposes.").

In sum, because the statute's text is adequately informative, we need not look outside ERISA itself to conclude with security that Congress intended working owners to qualify as plan participants.[5]

Congress' aim is advanced by our reading of the text. The working employer's opportunity personally to participate and gain ERISA coverage serves as an incentive to the creation of plans that will benefit employer and nonowner employees alike. See Brief for United States as *Amicus Curiae* 21–22. Treating working owners as participants not only furthers ERISA's purpose to promote and facilitate employee benefit plans. Recognizing the working owner as an ERISA-sheltered plan participant also avoids the anomaly that the same plan will be controlled by discrete regimes: federal-law governance for the nonowner employees; state-law governance for the working owner. See, *e.g.*, *Agrawal*, 205 F.3d, at 302 (because sole shareholder does not rank as a plan participant under ERISA, his state-law claims against insurer are not preempted). ERISA's goal, this Court has emphasized, is "uniform national treatment of pension benefits." *Patterson v. Shumate*, 504 U.S. 753, 765 (1992). Excepting working owners from the federal Act's coverage would generate administrative difficulties and is hardly consistent with a national uniformity goal. Cf. *Madonia*, 11 F.3d, at 450 ("Disallowing shareholders . . . from being plan 'participants' would result in disparate treatment of corporate employees' claims, thereby frustrating the statutory purpose of ensuring similar treatment for all claims relating to employee benefit plans.").

We note finally that a 1999 Department of Labor advisory opinion accords with our comprehension of Title I's definition and coverage provisions. Pension and Welfare Benefits Admin., U.S. Dept. of Labor, Advisory Opinion 99–04A, 26 BNA Pension and Benefits Rptr. 559 (hereinafter Advisory Opinion 99–04A). Confirming that working owners may qualify as participants in ERISA-protected plans, the Department's opinion concludes:

> "In our view, the statutory provisions of ERISA, taken as a whole, reveal a clear Congressional design to include 'working owners' within the definition of 'participant' for purposes of Title I of ERISA. Congress could not have intended that a pension plan operated so as to satisfy the complex tax qualification rules applicable to benefits provided to 'owner-employees' under the provisions of Title II of ERISA, and with respect to which an employer faithfully makes the premium payments required to protect the benefits payable under the plan to such individuals under Title IV of ERISA, would somehow transgress against the limitations of the definitions contained in Title I of ERISA. Such a result would cause an intolerable conflict between the separate titles of ERISA, leading to the sort of 'absurd results' that the Supreme Court warned against in *Nationwide Mutual Insurance Co. v. Darden*, 503 U.S. 318 (1992)." *Id.*, at 560–561 (footnote omitted).

This agency view on the qualification of a self-employed individual for plan participation reflects a "body of experience and informed judgment to which courts and litigants may properly resort for guidance."

[5] We do not suggest that each provision described *supra*, at 9–12, in isolation, would compel the Court's reading. But cf. post, at 1–2 (THOMAS, J., concurring in judgment). In combination, however, the provisions supply "specific guidance" adequate to obviate any need to expound on common law. See *Darden*, 503 U.S., at 323.

Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944).

B

The Sixth Circuit's leading decision in point — its 1992 determination in *Fugarino* — relied in large part, on an incorrect reading of a Department of Labor regulation, 29 CFR Sec. 2510.3–3. The *Fugarino* court read the Department's regulation to rule out classification of a working owner as an employee of the business he owns. Entitled "Employee benefit plan," the regulation complements Sec. 3(3) of ERISA, 29 U.S.C. Sec. 1002(3), which defines "employee benefit plan," see *supra*, at 2, the regulation provides, in relevant part:

> "(b) Plans without employees. For purposes of title I of the Act and this chapter, the term 'employee benefit plan" shall not include any plan, fund or program, other than an apprenticeship or other training program, under which no employees are participants covered under the plan, as defined in paragraph (d) of this section. For example, a so-called 'Keogh' or 'H.R. 10' plan under which only partners or only a sole proprietor are participants covered under the plan will not be covered under title I. However, a Keogh plan under which one or more common law employees, in addition to the self-employed individuals, are participants covered under the plan, will be covered under title I. . . .
>
> "(c) Employees. *For purposes of this section*:
>
> > "(1) An individual and his or her spouse shall not be deemed to be employees with respect to a trade or business, whether incorporated or unincorporated, which is wholly owned by the individual or by the individual and his or her spouse, and
> >
> > "(2) A partner in a partnership and his or her spouse shall not be deemed to be employees with respect to the partnership." 29 CFR Sec. 2510.3–3 (2003) (emphasis added and deleted).

In common with other Courts of Appeals that have held working owners do not qualify as participants in ERISA-governed employee benefit plans, the Sixth Circuit apparently understood the regulation to provide a generally applicable definition of the term "employee," controlling for all Title I purposes. *Fugarino*, 969 F.2d, at 185–186 ("As a result of [the] regulatio[n], a plan whose sole beneficiaries are the company's owners cannot qualify as a plan under ERISA. Further, an employer cannot ordinarily be an employee or participant under ERISA." (citation omitted)). See also *Kwatcher*, 879 F.2d, at 961 ("By its terms, the regulation unambiguously debars a sole shareholder . . . from 'employee' status, notwithstanding that he may work for the corporation he owns, shoulder to shoulder with eligible (non-owner) employees."); *Giardono*, 867 F.2d, at 412 ("[This] regulatio[n] exclude[s] from the definition of an employee any individual who wholly owns a trade or business, whether incorporated or unincorporated.").

Almost eight years after its decision in *Fugarino*, in *Agrawal*, the Sixth Circuit implied that it may have misread the regulation: "Th[e] limiting definition of employee [in Sec. 2510.3–3(c)] addresses the threshold issue of whether an ERISA plan exists. It is not consistent with the purpose of ERISA to apply this limiting definition of employee to the statutory definitions of participant and beneficiary." 205 F.3d, at 303. The Circuit, however, did not overrule its earlier interpretation. See 287 F.3d, at 525 (case below) ("[T]he three judge panel before which this appeal is currently pending has no authority to overrule *Fugarino*."); *Agrawal*, 205 F.3d, at 302 ("the decision in the present case is preordained by the *Fugarino* holding").

The Department of Labor's 1999 advisory opinion, see *supra*, at 13–14, interprets the "Employee benefit plan" regulation as follows:

> "In its regulation at 29 C.F.R. 2510.3–3, the Department clarified that the term 'employee benefit plan' as defined in section 3(3) of Title I does not include a plan the only participants of which are '[a]n individual and his or her spouse . . . with respect to a trade or business, whether incorporated or unincorporated, which is wholly owned by the individual or by the individual and his or her spouse' or '[a] partner in a partnership and his or her spouse.' The regulation further specifies, however, that a plan that covers as participants 'one or more common law employees, in addition to the self-employed individuals' will be included in the definition of 'employee benefit plan' under section 3(3). *The conclusion of this opinion, that such 'self-employed individuals' are themselves 'participants' in the covered plan, is fully consistent with that regulation*. Advisory Opinion 99–04A, at 561, n. 7 (emphasis added).

This agency view, overlooked by the Sixth Circuit, see Brief for United States as *Amicus Curiae* 26, merits the Judiciary's respectful consideration. Cf. *Clackamas Gastroenterology Assoc., P.C.*, 538 U.S. at — (slip op., at 9) (EEOC guidelines under the Americans with Disabilities Act of 1990 are persuasive).

The Department's regulation itself reveals the definitional Prescription's limited scope. The prescription describes "employees" only "[f]or purposes of this section," see *supra*, at 15 (emphasis deleted), *i.e.*, the section defining "employee benefit plans." Accordingly, the regulation addresses only what plans qualify as "employee benefit plans" under Title I of ERISA. Plans that cover only sole owners or partners and their spouses, the regulation instructs, fall outside Title I's domain.[6] Plans covering working owners *and* their nonowner employees, on the other hand, fall entirely within ERISA's compass.[7] See *Vega*, 188 F.3d, at 294 ("We . . . interpret the regulatio[n] to define employee only for purposes of

[6] Courts agree that if a benefit plan covers only working owners, it is not covered by Title I. See, *e.g.*, *Slamen v. Paul Revere Life Ins. Co.*, 166 F.3d 1102, 1105 (CA11 1999) (sole shareholder is not a participant where disability plan covered only him); *In re Watson*, 161 F.3d 593, 597 (CA9 1998) (sole shareholder is not a participant where retirement plan covered only him); *SEC v. Johnston*, 143 F.3d 260, 262–263 (CA6 1998) (owner is not a participant where pension plan covered only owner and "perhaps" his wife); *Schwartz v. Gordon*, 761 F.2d 864, 867 (CA2 1985) (self-employed individual is not a participant where he is the only contributor to a Keogh plan). Such a plan, however, could qualify for favorable tax treatment. See Brief for United States as *Amicus Curiae* 18, n. 9.

[7] Section 2510.3–3's preamble supports this interpretation. The preamble states in relevant part:

> "According to the comments [concerning proposed Sec. 2510.3–3], a definition of 'employee' excluding self-employed individuals might raise problems under section 404(a)(1) with respect to disbursements to self-employed individuals from 'Keogh' or 'H.R. 10' plans covering both self-employed individuals and 'common law' employees. *Therefore, the definition of 'employee' formerly appearing in proposed Sec. 2510.3–6 has been inserted into Sec. 2510.3–3 and restricted in scope to that section*." 40 Fed. Reg. 34528 (1975) (emphasis added).

determining the existence of an ERISA plan."); *Madonia*, 11 F.3d, at 449–450 ("[T]he regulation does not govern the issue of whether someone is a 'participant' in an ERISA plan, once the existence of that plan has been established. This makes perfect sense: once a plan has been established, it would be anomalous to have those persons benefiting from it governed by two disparate sets of legal obligations.").

Also in common with other Courts of Appeals that have denied participant status to working owners, the Sixth Circuit's leading decision mistakenly relied, in addition, on ERISA's "anti-inurement" provision, 29 U.S.C. Sec. 1103(c)(1), which prohibits plan assets from inuring to the benefit of employers. See *Fugarino*, 969 F.2d, at 186 ("A fundamental requirement of ERISA is that 'the assets of a plan shall never inure to the benefit of any employer. . . .'"); *Kwatcher*, 879 F.2d, at 960 ("Once a person has been found to fit within the 'employer' integument, [Sec. 1103(c)(1)] prohibits payments to him from a qualified plan."); *Giardono*, 867 F.2d, at 411 ("It is a fundamental requirement of ERISA that '. . . the assets of a plan shall never inure to the benefit of any employer. . . .'").

Correctly read, however, the anti-inurement provision does not preclude Title I coverage of working owners as plan participants. It states that, with enumerated exceptions, "the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan." 29 U.S.C. Sec. 1103(c)(1). The provision demands only that plan assets be held for supplying benefits to plan participants. Like the Department of Labor regulation, see *supra*, at 14–15, the anti-inurement provision does not address the discrete question whether working owners, along with nonowner employees, may be participants in ERISA-sheltered plans. As the Fifth Circuit observed in *Vega*:

> "Th[e] [anti-inurement] provision refers to the congressional determination that funds contributed by the employer (and, obviously, by the [nonowner] employees . . .) must never revert to the employer; it does not relate to plan benefits being paid with funds or assets of the plan to cover a legitimate pension or health benefit claim by an employee who happens to be a stockholder or even the sole shareholder of a corporation." 188 F.3d, at 293, n. 5.

ERISA's anti-inurement provision is based on the analogous exclusive benefit provision in the IRC, 26 U.S.C. Sec. 401(a)(2), which has never been understood to bar tax-qualified plan participation by working owners. See H.R. Conf. Rep. No. 93–1280, pp. 302–303 (1974); Brief for United States as *Amicus Curiae* 29. The purpose of the anti-inurement provision, in common with ERISA's other fiduciary responsibility provisions, is to apply the law of trusts to discourage abuses such as self-dealing, imprudent investment, and misappropriation of plan assets, by employers and others. See, *e.g.*, *Prudential Ins. Co. of Am. v. Doe*, 76 F.3d 206, 209 (CA8 1996). Those concerns are not implicated by paying benefits to working owners who participate on an equal basis with nonowner employees in ERISA-protected plans.

In sum, the anti-inurement provision, like the Department of Labor regulation, establishes no categorical barrier to working owner participation in ERISA plans. Whether Yates himself, in his handling of loan repayments, see *supra*, at 4, engaged in conduct inconsistent with the anti-inurement provision is an issue not yet reached by the courts below, one on which we express no opinion.

* * *

For the reasons stated, the judgment of the Court of Appeals for the Sixth Circuit is reversed, and the case is remanded for further proceedings consistent with this opinion, including consideration of questions earlier raised but not resolved. Specifically, given the undisputed facts concerning Yates's handling of the loan, *i.e.*, his failure to honor the periodic repayment requirements: (1) Did the November 1996 close-to-bankruptcy repayments, despite the prior defaults, become "a portion of [Yates's] interest in a qualified retirement plan . . . excluded from his bankruptcy estate," App. to Pet. for Cert. 40a, and (2) if so, were the repayments "beyond the reach of [the Bankruptcy] [T]rustee's power to avoid and recover preferential transfers," *id.*, at 47a?

It is so ordered.

SUPREME COURT OF THE UNITED STATES

No. 02-458

RAYMOND B. YATES, M.D., P.C. PROFIT SHARING PLAN, AND RAYMOND B. YATES, TRUSTEE, PETITIONERS *v.* WILLIAM T. HENDON, TRUSTEE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

March 2, 2004

JUSTICE SCALIA, concurring in the judgment.

The Court uses a sledgehammer to kill a gnat — though it may be a sledgehammer prescribed by *United States v. Mead Corp.*, 533 U.S. 218 (2001). I dissented from that case, see *id.*, at 257, and remain of the view that authoritative interpretations of law by the implementing agency, if reasonable, are entitled to respect. *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

In the present case the Solicitor General of the United States, in a brief signed by the Acting Solicitor of Labor, has put forward as the "considered view of the agency charged by Congress with the administration and enforcement of Title I of ERISA," an interpretation of the relevant terms of that Act which would allow working owners (including sole owners, such as Dr. Yates) to be plan participants under the Employee Retirement Income Security Act of 1974 (ERISA). Brief for United States as *Amicus Curiae* 26. There is no doubt that this position is the official view of the Department of Labor, and that it has not been contrived for this litigation. The Solicitor General's brief relies upon a Department of Labor advisory opinion, issued more than five years ago, which concluded that "the statutory provisions of ERISA, taken as a whole, reveal a clear Congressional design to include 'working owners' within the definition of 'participant' for purposes of Title I of ERISA." Pension and Welfare Benefits Admin., U.S. Dept. of

Labor, Advisory Opinion 99–04A (Feb. 4, 1999), 26 BNA Pension and Benefits Rptr. 559, 560 (1999).

The Department's interpretive conclusion is certainly reasonable (the Court's lengthy analysis says that it is inevitable); it is therefore binding upon us. See *Barnhart v. Thomas*, 540 U.S. _____, _____ (2003) (slip op., at 6). I would reverse the judgment of the Sixth Circuit on that basis. The Court's approach, which denies many agency interpretations their conclusive effect and thrusts the courts into authoritative judicial interpretation, deprives administrative agencies of two of their principal virtues: (1) the power to resolve statutory questions promptly, and with nationwide effect, and (2) the power (within the reasonable bounds of the text) to change the application of ambiguous laws as time and experience dictate. The Court's approach invites lengthy litigation in all the circuits — the product of which (when finally announced by this Court) is a rule of law that only Congress can change.

SUPREME COURT OF THE UNITED STATES

No. 02-458

RAYMOND B. YATES, M.D., P.C. PROFIT SHARING PLAN, AND RAYMOND B. YATES, TRUSTEE, PETITIONERS *v.* WILLIAM T. HENDON, TRUSTEE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

March 2, 2004

JUSTICE THOMAS, concurring in the judgment.

I agree with the Court that the judgment of the Court of Appeals should be reversed. The Court persuasively addresses the Court of Appeals' many errors in this case. See *ante*, at 14–19. I do not, however, find convincing the Court's reliance on textual "indications," *ante*, at 8. The text of the Employee Retirement Income Security Act of 1974 (ERISA), is certainly consistent with the Court's interpretation of the word "employee" to include so-called "working owners."* *Ibid*. However, the various Title I exemptions relied upon so heavily by the Court, see *ante*, at 9–11, are equally consistent with an interpretation of "employee" that would not include all "working owners."

As an example, the Court places weight on the exception to the exemption from 29 U.S.C. Sec. 1106, which bars loans made to parties in interest that are "'made available to highly compensated employees . . . in an amount greater than the amount made available to other employees.'" *Ante*, at 10–11 (quoting 29 U.S.C. Sec. 1108(b)(1)(B)). The Court notes that "some working owners . . . qualify as 'highly compensated employees.'" *Ante*, at 11. That may be true, but there are surely numerous "highly compensated employees" who would both be "employees" under the usual, common-law meaning of that term (and hence "employees" under ERISA, see *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318 (1992)), and would also not be considered "working owners" as the Court uses the term. It is entirely possible, then, that Congress was merely attempting to exclude these individuals from Sec. 1106, rather than assuming that all "working owners" were "employees." Hence the existence of this exception tells us nothing about whether Congress "intended working owners" to be "employees" under ERISA. *Ante*, at 8.

Since the text is inconclusive, we must turn to the common-law understanding of the term "employee." *Darden*, *supra*, at 322–323. On remand, then, I would direct the Court of Appeals to address whether the common-law understanding of the term "employee," as used in ERISA, includes Dr. Yates. I would be surprised if it did not, see *In re Baker*, 114 F.3d 636, 639 (CA7 1997) (corporation's separate legal existence from shareholder must be respected), *Madonia v. Blue Cross & Blue Shield of Virginia*, 11 F.3d 444, 448–449 (CA4 1993) (same), but this is a matter best resolved, in the first instance, by the court below.

* The Court does not clearly define who exactly makes up this class of "working owners," even though members of this class are now considered categorically to fall under ERISA's definition of "employee."

Part III. Administrative, Procedural, and Miscellaneous

Public Comment Invited on Recommendations for 2004–2005 Guidance Priority List

Notice 2004–26

The Department of Treasury and Internal Revenue Service invite public comment on recommendations for items that should be included on the 2004–2005 Guidance Priority List.

Treasury's Office of Tax Policy and the Service use the Guidance Priority List each year to identify and prioritize the tax issues that should be addressed through regulations, revenue rulings, revenue procedures, notices, and other published administrative guidance. The 2004–2005 Guidance Priority List establishes the guidance that the Treasury Department and the Service intend to issue from July 1, 2004, through June 30, 2005. The Treasury Department and the Service recognize the importance of public input to formulate a Guidance Priority List that focuses resources on guidance items that are most important to taxpayers and tax administration.

In reviewing recommendations and selecting projects for inclusion on the 2004–2005 Guidance Priority List, the Treasury Department and the Service will consider the following:

1. Whether the recommended guidance is consistent with the Internal Revenue Code and Congressional intent;

2. Whether the recommended guidance promotes sound tax administration;

3. Whether taxpayers can easily understand and apply the recommended guidance;

4. Whether the Service can administer the recommended guidance on a uniform basis; and

5. Whether the recommended guidance reduces controversy and lessens the burden on taxpayers or the Service.

Taxpayers may submit recommendations for guidance at any time during the year. Please submit recommendations by April 30, 2004, for possible inclusion on the original 2004–2005 Guidance Priority List. The Service will update the 2004–2005 Guidance Priority List quarterly to reflect additional guidance that the Treasury Department and the Service intend to publish during the plan year. The quarterly updates allow the Treasury Department and the Service to respond to the need for additional guidance that may arise during the plan year. Generally, recommendations for guidance received after April 30, 2004, will be reviewed for inclusion in the next quarterly update if received by August 31, 2004; November 30, 2004; or February 28, 2005, respectively.

Taxpayers are not required to submit recommendations for guidance in a particular format. Taxpayers should, however, briefly describe the recommended guidance and explain the need for the guidance. In addition, taxpayers may include an analysis of how the issue should be resolved.

Taxpayers should send written comments to:

Internal Revenue Service
Attn: CC:PA:LPD:PR
(Notice 2004–26)
Room 5226
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

or hand deliver comments between the hours of 8 a.m. and 5 p.m. to:

Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:PR
(Notice 2004–26)
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Alternatively, taxpayers may submit comments electronically via e-mail to the following address: *Notice.Comments@irscounsel.treas.gov*. Taxpayers should include "Notice 2004–26" in the subject line. All comments will be available for public inspection and copying in their entirety.

For further information regarding this notice, contact Crystal Foster of the Office of Associate Chief Counsel (Procedure and Administration) at (202) 622–7326 (not a toll-free call).

Loss Deductions for Diminution in Value of Stock Attributable to Corporate Misconduct

Notice 2004–27

The Internal Revenue Service and Treasury Department are aware that some taxpayers who acquired stock on the open market for investment have been advised that they may be able to deduct as a theft loss the decline in market value of their stock caused by disclosure of accounting fraud or other illegal misconduct of the officers or directors of the corporation that issued the stock. The purpose of this notice is to advise taxpayers that the Service intends to disallow such deductions and may impose penalties under § 6662.

Section 165(a) of the Internal Revenue Code allows a deduction for any loss sustained during the taxable year not compensated for by insurance or otherwise. Under § 165(c) losses for individuals are limited to (1) losses incurred in a trade or business, (2) losses incurred in any transaction entered into for profit, though not connected with a trade or business, and (3) losses of property not connected with a trade or business or a transaction entered into for profit, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft. Section 1.165–1(b) of the Income Tax Regulations generally provides that, to be allowable as a deduction under section 165(a), a loss must be evidenced by a closed and completed transaction, fixed by an identifiable event or events, and actually sustained during the taxable year.

Section 1.165–4(a) provides that no deduction shall be allowed under § 165(a) solely on account of a decline in the value of stock owned by the taxpayer when the decline is due to a fluctuation in the market price of the stock or to another similar cause. However, a deduction is allowed under § 165(a) if the stock is worthless and has no recognizable value. A decline in the value of stock owned by the taxpayer is not allowed as a deduction under § 165(a) until

the taxable year in which the loss is actually sustained as a result of the sale or exchange of the stock or the stock becoming wholly worthless.

Section 165(f) provides that losses from sales or exchanges of capital assets shall be allowed only to the extent allowed in sections 1211 and 1212. Stock held for investment is a capital asset under section 1221. Sections 1211 and 1212 limit the amount that individual taxpayers may deduct for losses from sales or exchanges of capital assets and provide rules for carrying forward to subsequent years the amount of any excess capital loss.

Under § 165(g)(1), if any stock that is a capital asset in the hands of a taxpayer, such as stock purchased as an investment, becomes worthless during a taxable year, the resulting loss is treated as a loss from the sale or exchange of a capital asset (*i.e.*, a capital loss). Section 1.165–5(c) explains that if the stock becomes wholly worthless during a taxable year, the resulting loss may be deducted under § 165(a) subject to the limitations imposed on capital losses under §§ 1211 and 1212 and the regulations thereunder.

Therefore, under § 165(a), subject to the limitations of §§ 1211 and 1212, a taxpayer who owns stock that was acquired on the open market for investment and that has declined in value is allowed a deduction for a capital loss in the taxable year in which the stock is sold or exchanged or becomes wholly worthless.

Sections 165(e) and 1.165–8(a)(2) provide that, in general, a loss arising from a theft shall be treated under § 165(a) as sustained during the taxable year in which the taxpayer discovers the loss. Section 1.165–1(d)(3) provides that if in the year of discovery there exists a claim for reimbursement with respect to which the taxpayer has a reasonable prospect of recovery, the portion of the loss that may be reimbursed is not treated as sustained until the tax year in which it can be ascertained with reasonable certainty that reimbursement will not be received.

Whether a loss constitutes a theft loss is determined by examining the law of the state where the alleged theft occurred. *Edwards v. Bromberg*, 232 F.2d 107, 111 (5th Cir. 1956); *Viehweg v. Commissioner*, 90 T.C. 1248, 1253 (1988). Thus, to claim a theft loss, the taxpayer must prove that the "loss resulted from a taking of property that is illegal under the law of the state where it occurred and that the taking was done with criminal intent." Rev. Rul. 72–112, 1972–1 C.B. 60.

In cases involving stock purchased on the open market, the courts have consistently disallowed theft loss deductions relating to a decline in the value of the stock that was attributable to corporate officers misrepresenting the financial condition of the corporation, even when the officers were indicted for securities fraud or other criminal violations. In *Paine v. Commissioner*, 63 T.C. 736, *aff'd without published opinion*, 523 F.2d 1053 (5th Cir. 1975), the taxpayers claimed a theft loss deduction for a decline in value of stock stemming from misrepresentations of the financial status of the corporation by corporate officials. The court noted that the taxpayers did not purchase the stock from the corporate officers who made the misrepresentations, but on the open market. In *MTS International Inc. v. Commissioner*, 169 F.3d 1018 (6th Cir. 1999), an individual taxpayer sold at a loss stock that was acquired on a public stock exchange and argued that the substantial decline in value was due to criminal conduct by the corporation's officers. The Sixth Circuit concluded that the loss was not a theft loss. *See also Crowell v. Commissioner*, T.C. Memo. 1986–314; *DeFusco v. Commissioner*, T.C. Memo. 1979–230; *Barry v. Commissioner*, T.C. Memo. 1978–215; and Rev. Rul. 77–17, 1977–1 C.B. 44.

Accordingly, the Service will disallow a deduction for a theft loss under § 165(a) relating to a decline in the value of stock that was acquired on the open market for investment. If the stock is sold or exchanged or becomes wholly worthless, any resulting loss is a capital loss.

DRAFTING INFORMATION

The principal author of this notice is Norma Rotunno of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice, please contact Ms. Rotunno at (202) 622–7900 (not a toll-free call).

Frivolous Arguments to Avoid Concerning Statutory and Nonstatutory Stock Options

Notice 2004–28

The Internal Revenue Service is aware that certain promoters are advising taxpayers to take highly questionable, and in most cases meritless, positions, described below, on current and amended returns regarding income or alternative minimum tax ("AMT") due upon the exercise of nonstatutory or statutory stock options. This notice alerts taxpayers that the Service intends to challenge such positions and will treat them as frivolous in appropriate cases. However, the Service will consider each position and will not reject or contest it solely because it is submitted along with a frivolous position. *See* Treas. Reg. § 1.6694–2(c)(2) ("a 'frivolous' position with respect to an item is one that is patently improper"). The Service also may apply civil or criminal penalties to taxpayers and to promoters of these positions.

Income Tax Treatment of Stock Options Generally

The federal income tax treatment of stock options granted in exchange for services is well established. In general, the income tax consequences associated with an option arise when the option is exercised. When an employee exercises a compensatory stock option (commonly known as a "nonstatutory option"), both § 83 of the Internal Revenue Code (Code) and long-standing judicial authority require that the difference between the fair market value of the stock and the option exercise price be included in the employee's gross income as compensation. *See, e.g.*, Commissioner v. LoBue, 351 U.S. 243 (1956). In the case of stock purchased under an incentive stock option (or a "statutory option") taxed under §§ 421 and 422, § 56 provides that the difference between the fair market value of the stock and the option exercise price must be included in the employee's gross income for purposes of computing AMT.

Statutory stock options are not subject to tax on the date of grant. Nonstatutory stock options rarely are subject to tax on the date of grant, and taxation at grant

typically occurs only if an option is actively traded on an established securities market on that date or, if not so traded, it has a readily ascertainable fair market value. *See* § 83(a) and (e), and § 1.83–7(a) and (b) of the Income Tax Regulations. A non-publicly traded nonstatutory stock option is considered to have a readily ascertainable fair market value on the grant date only if, on that date, it satisfies four conditions: (1) the option is transferable; (2) the option is exercisable immediately in full by the optionee; (3) the option or the property subject to the option is not subject to any restriction or condition which has a significant effect upon the fair market value of the option; and (4) the fair market value of the option privilege is readily ascertainable. § 1.83–7(b).

For more information regarding the federal tax treatment of stock options granted in exchange for services, please consult Publication 525, *"Taxable and Nontaxable Income,"* pages 9–11.

Positions Promoted

The positions being promoted include, but are not limited to, the following:

- **"The options should have been taxed at their grant date rather than their exercise date."** Promoters of this argument typically claim that the proper time for an employee to measure taxable income from a stock option is when the option is granted (before the stock has appreciated) rather than when it is exercised (after the stock has appreciated). This claim will rarely be supported by the facts. For a nonstatutory option, unless the requirements for taxation at grant as described above are satisfied, the proper time for measurement and inclusion of income is on the date of exercise. A statutory option will never be subject to tax on grant. *See* §§ 421 and 422.

- **"The fair market value of stock purchased under an option is reduced by any restriction placed on the stock by the employer that prohibits the employee from selling the stock for a specified period of time."** Promoters of this argument typically claim that if an employee cannot sell stock purchased under an option for a period of time because of an agreement with an employer, then the value of the stock cannot be as high as the value of the same stock that does not have that restriction. This claim is without merit because § 83(a) clearly requires that the value of property transferred in connection with the performance of services must be determined without regard to restrictions that will lapse, such as a requirement to hold shares for a period of time. *See also* § 1.83–1(a)(1) and *Sakol v. Commissioner*, 67 T.C. 986 (1977), *aff'd*, 574 F.2d 694 (2nd Cir. 1978), *cert denied*, 439 U.S. 859 (1978).

- **"When, due to a margin call, a broker sells a taxpayer's stock that was purchased under a nonstatutory option, the stock having been pledged as security for a loan to pay the exercise price, that sale is a forfeiture of the stock that causes an ordinary loss rather than a capital loss."** Promoters of this argument generally claim that a sale of stock required by a broker's margin call should be treated as an ordinary loss. This claim is baseless because, when an employee is the beneficial owner of shares held by the employee's broker pursuant to a stock option exercise, the stock is then a capital asset to the employee. *See* § 1221. Capital gains or losses occur upon the subsequent sale of the stock, such as pursuant to a margin call. The same analysis applies for purposes of AMT, and gain or loss on disposition due to a margin call would be capital gain or loss for AMT purposes. *See* §§ 56, 421 and 422.

- **"The purchase of the stock using borrowed funds was not in substance a purchase because the employee did not have the ability to repay the loan."** Promoters of this argument typically assert that an employee's purchase of shares pursuant to a stock option in exchange for a note to pay the purchase price should not be respected where the employee is subsequently unable to pay the debt. This claim will fail where, in fact, beneficial ownership of the stock was transferred to the employee, irrespective of the employee's subsequent ability to repay the debt. *See* § 1.83–3(a).

- **"Options should have been viewed as the economic equivalent of the underlying stock and thus were not subject to any taxation of the spread on exercise."** Promoters of this argument typically claim that because an option and the underlying stock are functional equivalents, there is no gain when the employee exercises the option. As discussed above, generally, when an employee is granted a nonstatutory option, § 83 requires the inclusion of income equal to the difference between the stock's fair market value and the exercise price when the option is exercised. Section 56(b)(3) requires the employee to include that difference in AMT income when an employee exercises a statutory stock option.

These positions and other similar claims that disregard the long-standing judicial and statutory authorities concerning the taxation of statutory and nonstatutory options will be treated as frivolous in appropriate circumstances.

In evaluating positions of this kind, the Service will determine the additional tax due from the taxpayer according to the principles outlined above. In addition to liability for tax due plus statutory interest, individuals who claim tax benefits on their returns based on these and other frivolous arguments face substantial civil and criminal penalties. Potentially applicable civil penalties include: (1) the § 6662 accuracy-related penalty, which is equal to 20 percent of the amount of taxes the taxpayer should have paid; (2) the § 6663 penalty for civil fraud, which is equal to 75 percent of the amount of taxes the taxpayer should have paid; (3) a $500 penalty under § 6702 for filing a frivolous return; and (4) a penalty of up to $25,000 under § 6673 if the taxpayer makes frivolous arguments in the United States Tax Court.

Taxpayers filing returns based on these or similar positions also may face criminal prosecution for: (1) attempting to evade or defeat tax under § 7201 for which the penalty is a fine of up to $100,000 and imprisonment for up to 5 years; or (2) making false statements on a return under § 7206 for which the penalty is a fine of up to $100,000 and imprisonment for up to 3 years.

Persons who promote these or similar positions and those who assist taxpayers in claiming tax benefits based on them also face penalties. Potential penalties include: (1) a $250 penalty for each return prepared by an income tax return preparer who knew or should have known that the taxpayer's argument was frivolous (or $1,000 for each return where the return preparer's actions were willful, intentional or reckless); (2) a $1,000 penalty under § 6701 for aiding and abetting the understatement of tax; and (3) criminal prosecution under § 7206 for which the penalty is a fine of up to $100,000 and imprisonment for up to 3 years for assisting or advising about the preparation of a false return or other document under the internal revenue laws. Promoters and others who assist taxpayers in engaging in these schemes also may be enjoined from doing so under § 7408.

Taxpayers who have submitted returns relying on these or similar claims should amend them as soon as possible to avoid accruing additional penalties. Taxpayers should consult with a tax advisor to take appropriate corrective action.

For more information regarding the taxability of stock options, taxpayers can contact the Office of Division Counsel/Associate Chief Counsel (Tax Exempt/Government Entities) at (202) 622–6030 (not a toll-free call). For information regarding AMT, contact the Office of Associate Chief Counsel (Income Tax & Accounting) at (202) 622–4920 (not a toll-free call). For information regarding penalties, contact the Office of Associate Chief Counsel (Procedure and Administration) at (202) 622–4940 (not a toll-free call).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also, Part 1, §§ 162, 263, 446, 461, 481; 1.167(a)–3(b), 1.263(a)–4, 1.263(a)–5, 1.446–1, 1.461–4, 1.461–5, 1.481–1.)

Rev. Proc. 2004–23

SECTION 1. PURPOSE

This revenue procedure provides the exclusive administrative procedures under which a taxpayer described in section 3 of this revenue procedure may obtain automatic consent for the taxpayer's first taxable year ending on or after December 31, 2003, to change to a method of accounting provided in §§ 1.263(a)–4, 1.263(a)–5, and 1.167(a)–3(b) of the Income Tax Regulations (the "final regulations").

SECTION 2. BACKGROUND

.01 On January 24, 2002, the Internal Revenue Service and Treasury Department published an advance notice of proposed rulemaking (ANPRM) in the **Federal Register** (REG–125638–01, published in the Bulletin as Announcement 2002–9, 2002–1 C.B. 536 [67 FR 3461]) announcing an intention to provide guidance on the extent to which § 263(a) of the Internal Revenue Code requires taxpayers to capitalize amounts paid to acquire, create, or enhance intangible assets. On December 19, 2002, the Service and Treasury Department published a notice of proposed rulemaking proposing regulations under § 263(a) relating to the capitalization requirements. On January 5, 2004, the Service and Treasury Department published final regulations in the **Federal Register** (T.D. 9107, 2004–7 I.R.B. 447 [69 FR 436]). Section 1.263(a)–4 prescribes the extent to which taxpayers must capitalize amounts paid or incurred to acquire or create (or to facilitate the acquisition or creation of) intangibles. Section 1.263(a)–5 prescribes the extent to which taxpayers must capitalize amounts paid or incurred to facilitate an acquisition of a trade or business, a change in the capital structure of a business entity, and certain other transactions. Section 1.167(a)–3(b) provides a safe harbor useful life for certain intangible assets. The final regulations under §§ 1.263(a)–4 and 1.263(a)–5 are effective for amounts paid or incurred on or after December 31, 2003. The final regulations under § 1.167(a)–3(b) are effective for intangible assets created on or after December 31, 2003.

.02 Sections 1.263(a)–4(p) and 1.263(a)–5(n) provide that a taxpayer seeking to change to a method of accounting provided in the final regulations must secure the consent of the Commissioner in accordance with the requirements of § 1.446–1(e). In addition, §§ 1.263(a)–4(p) and 1.263(a)–5(n) provide that, for the taxpayer's first taxable year ending on or after December 31, 2003, the taxpayer is granted the consent of the Commissioner to change to a method of accounting provided in the final regulations, provided the taxpayer follows the administrative procedures issued under § 1.446–1(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in accounting method (for further guidance, for example, see Rev. Proc. 2002–9, 2002–1 C.B. 327, as modified and clarified by Announcement 2002–17, 2002–1 C.B. 561, modified and amplified by Rev. Proc. 2002–19, 2002–1 C.B. 696, and amplified, clarified, and modified by Rev. Proc. 2002–54, 2002–2 C.B. 432). The final regulations further provide that any applicable § 481(a) adjustment for a change to a method of accounting provided in the final regulations for a taxpayer's first taxable year ending on or after December 31, 2003, is determined by taking into account only amounts paid or incurred in taxable years ending on or after January 24, 2002. The preamble to the final regulations states that the Service may issue additional guidance for utilizing the automatic consent procedures to change to a method of accounting provided in the regulations. This revenue procedure constitutes the exclusive guidance for utilizing the automatic consent procedures to change to a method of accounting provided in the final regulations for a taxpayer's first taxable year ending on or after December 31, 2003. For changes in methods of accounting to which this revenue procedure applies, a taxpayer may not file an application for a change in method of accounting under Rev. Proc. 97–27, 1997–1 C.B. 680 (as modified and amplified by Rev. Proc. 2002–19, 2002–1 C.B. 696, as amplified and clarified by Rev. Proc. 2002–54, 2002–2 C.B. 432). See section 4.02(1) of Rev. Proc. 97–27.

.03 Section 1.446–1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting.

.04 Rev. Proc. 2002–9 provides procedures by which a taxpayer may obtain automatic consent to change to a method of accounting described in the Appendix of Rev. Proc. 2002–9.

.05 Rev. Rul. 90–38, 1990–1 C.B. 57, provides that, if a taxpayer uses an erroneous method of accounting for two or more consecutive taxable years, the tax-

payer has adopted a method of accounting. The ruling further provides that a taxpayer may not, without the Commissioner's consent, retroactively change from an erroneous to a permissible method of accounting by filing an amended return.

.06 This revenue procedure applies only for a taxpayer's first taxable year ending on or after December 31, 2003, for changes to methods of accounting provided in the final regulations. The Service intends to issue future guidance for changes in methods of accounting made for subsequent taxable years, including automatic consent procedures for some or all methods of accounting provided in the final regulations. For taxable years subsequent to the first taxable year ending on or after December 31, 2003, as in this revenue procedure, a term and condition of the Commissioner's consent with respect to a change to a method of accounting provided in the final regulations will be that any applicable § 481(a) adjustment will take into account only amounts paid or incurred in taxable years ending on or after January 24, 2002.

.07 As indicated in the preamble to the final regulations, the preamble to the notice of proposed rulemaking advised taxpayers not to seek to change a method of accounting in reliance upon the rules contained in the notice of proposed rulemaking until the rules were published as final regulations. The Service has received numerous Forms 3115 from taxpayers seeking consent to change to a method of accounting described in the notice of proposed rulemaking for taxable years prior to the effective date of the final regulations. For example, the Service has received numerous requests to change to a method of accounting of applying the 12-month rule contained in § 1.263(a)–4(f)(1) of the final regulations. *See also U.S. Freightways Corp. v. Commissioner*, 270 F.3d 1137 (7th Cir. 2001), *rev'g* 113 T.C. 329 (1999). As stated in the preamble to the final regulations, the Service suspended processing of these requests pending publication of the final regulations. The Service will not grant a request to change to a method of accounting provided in the final regulations for a year of change earlier than the effective date provided by the final regulations. Affected taxpayers will be notified and given the opportunity to withdraw their requests and obtain a refund of the user fee. Any request not withdrawn will be processed in accordance with the procedures under which it was filed (*e.g.*, Rev. Proc. 97–27) on the basis that the national office is adverse to the request.

SECTION 3. SCOPE

.01 This revenue procedure applies to a taxpayer that seeks, for the taxpayer's first taxable year ending on or after December 31, 2003, to change to a method of accounting provided in the final regulations.

.02 This revenue procedure also applies to a taxpayer that, for the taxpayer's first taxable year ending on or after December 31, 2003, in addition to seeking a change to a method of accounting provided in the final regulations, also seeks to change its method of accounting to utilize the 3½ month rule authorized by § 1.461–4(d)(6)(ii) or to utilize the recurring item exception authorized by § 1.461–5.

SECTION 4. APPLICATION

.01 *In general*. A taxpayer within the scope of this revenue procedure is, in accordance with section 6.01 of Rev. Proc. 2002–9, granted the consent of the Commissioner to change to a method of accounting provided in the final regulations (and, if desired, to also utilize the 3½ month rule authorized by § 1.461–4(d)(6)(ii) or the recurring item exception authorized by § 1.461–5) provided that the taxpayer follows the automatic change in method of accounting provisions in Rev. Proc. 2002–9, with the following modifications:

(1) The scope limitations in section 4.02 of Rev. Proc. 2002-9 do not apply;

(2) The taxpayer must prepare and file Form 3115, *Application for Change in Accounting Method*, in accordance with section 4.02 of this revenue procedure;

(3) The copy of Form 3115 must be sent to the following special address (note the special post office box number): Commissioner of Internal Revenue, Attention: CC:ITA (Automatic Rulings Branch, Rev. Proc. 2004-23 Filing) P.O. Box 7616, Benjamin Franklin Station, Washington, D.C. 20044 (or in the case of a private delivery service or hand delivery to the courier's desk: Commissioner of Internal Revenue, Attention: CC:ITA (Automatic Rulings Branch, Rev. Proc. 2004-23 Filing), 1111 Constitution Avenue, NW, Washington, D.C. 20224);

(4) The taxpayer must compute any applicable § 481(a) adjustment and take such adjustment into account in accordance with section 5 of this revenue procedure; and

(5) A taxpayer described in section 4.03(2) of this revenue procedure must file one or more amended federal income tax returns (amended returns) in accordance with section 4.03(3), (4), or (5), as applicable, of this revenue procedure.

.02 *Form 3115*. In preparing the Form 3115 referred to in section 4.01 of this revenue procedure, a taxpayer must comply with the following procedures:

(1) The taxpayer must use the current version of Form 3115 (Revised December 2003);

(2) The taxpayer may use one Form 3115 for all changes in method of accounting made pursuant to the final regulations;

(3) The taxpayer is required to complete only the following information on Form 3115:

(a) The identification section of Page 1 (above Part I);

(b) The signature section at the bottom of Page 1;

(c) Part I, Line 1(a). The designated automatic accounting method change number for changes in method of accounting made pursuant to this revenue procedure is No. "78";

(d) Part II, Lines 4(a) (and, if applicable, lines 4(f) and 4(g)), 5(a), 5(b), 9, 10, 12 (see section 5.02(2) of this revenue procedure if the taxpayer is making more than one change in method of accounting), and 16;

(e) Part IV, in accordance with section 5 of this revenue procedure; and

(f) Schedule E, if applicable;

(4) In addition to the other information required on line 12 of Form 3115, the taxpayer must include the citation to the paragraph of the final regulations that provides for the proposed method of accounting for each item (*e.g.*, § 1.263(a)–4(d)(6) or § 1.263(a)–4(f)), and, if applicable,

whether the taxpayer is also proposing to change to a method that uses the 3½ month rule authorized by § 1.461–4(d)(6)(ii) or the recurring item exception authorized by § 1.461–5 with respect to the item;

(5) In addition to the other information required on Schedule E of Form 3115 (if applicable), the taxpayer must include a statement as to whether the useful life is the safe harbor useful life prescribed by § 1.167(a)–3(b)(1) or § 1.167(a)–3(b)(1)(iv) and, if the useful life is the safe harbor useful life prescribed by § 1.167(a)–3(b)(1), a statement explaining why the intangible asset does not have a useful life the length of which can be estimated with reasonable accuracy; and

(6) A taxpayer that must file one or more amended returns as provided in section 4.03 of this revenue procedure to be eligible to use the automatic consent procedures of this revenue procedure must attach to the Form 3115 a written statement signed under penalties of perjury confirming that the taxpayer has filed the amended returns pursuant to section 4.03 of this revenue procedure.

.03 *Unauthorized change in a preceding year.*

(1) A taxpayer may change a method of accounting only with the consent of the Commissioner. § 1.446–1(e)(2). A taxpayer that changes a method of accounting without the consent of the Commissioner has made an unauthorized change in method of accounting. If a taxpayer makes an unauthorized change in method of accounting, the Service may adjust the taxpayer's taxable income during the examination of the taxpayer's income tax return for the taxable year the unauthorized change was made and for all affected subsequent years. As discussed above, the preamble to the notice of proposed rulemaking advised taxpayers not to seek to change a method of accounting in reliance on rules contained in the notice of proposed rulemaking until the rules were published as final regulations. The Service and Treasury Department are aware that some taxpayers, prior to the effective date of the final regulations, made an unauthorized change in method of accounting for an item the treatment of which is provided for in the final regulations. The Service and Treasury Department have determined that it is not appropriate for taxpayers that have made an unauthorized change in method of accounting for an item the treatment of which is provided for in the final regulations to obtain automatic consent under this revenue procedure without correcting such unauthorized change. Therefore, a taxpayer that made an unauthorized change in method of accounting for an item the treatment of which is provided for in the final regulations is eligible to use the automatic consent procedures provided in this revenue procedure only if the taxpayer amends prior federal income tax returns to correct the unauthorized change in method of accounting. However, as a matter of administrative grace, the Service and Treasury Department have limited the application of this section 4.03 to certain taxpayers described in section 4.03(2) of this revenue procedure.

(2) This section 4.03 applies to a taxpayer that —

(a) in a taxable year for which the due date of the federal income tax return (including extensions, regardless of whether such extension is automatic and whether or not actually requested) is after January 24, 2002 (the date of publication of the ANPRM) —

(i) made any unauthorized change in method of accounting for an item the treatment of which is provided for in the final regulations; or

(ii) changed the treatment of an item that is provided for in the final regulations in the taxable year immediately preceding the taxpayer's first taxable year ending on or after December 31, 2003, but has only used such treatment on one federal income tax return; or

(b) made an unauthorized change in method of accounting to a method of accounting that is provided in the final regulations in a taxable year for which the due date of the federal income tax return (including extensions, regardless of whether such extension is automatic and whether or not actually requested) is on or before January 24, 2002, and for which the statute of limitations has not yet expired, if the taxpayer wishes to use the automatic consent procedures to obtain the Commissioner's consent to change to the same method of accounting to which the taxpayer previously made the unauthorized change.

(3) A taxpayer described in section 4.03(2)(a)(i) of this revenue procedure is eligible to use the automatic consent procedures to obtain the Commissioner's consent to change to a method of accounting provided in the final regulations only if the taxpayer changes back to the prior method of accounting (*i.e.*, the method of accounting used for an item prior to making the unauthorized change for the item) for each item referred to in section 4.03(2)(a) of this revenue procedure by amending its federal income tax returns for all of the preceding taxable years in which the unauthorized method (or methods) was used.

(4) A taxpayer described in section 4.03(2)(a)(ii) of this revenue procedure is eligible to use the automatic consent procedures to obtain the Commissioner's consent to change to a method of accounting provided in the final regulations only if the taxpayer amends its federal income tax return for the preceding taxable year in which the unauthorized treatment was used to change the treatment of each item referred to in section 4.03(2)(a) of this revenue procedure to a treatment consistent with the taxpayer's historic method of accounting (*i.e.*, the method of accounting used for an item prior to changing the treatment of the item).

(5) A taxpayer described in section 4.03(2)(b) of this revenue procedure is eligible to use the automatic consent procedures to obtain the Commissioner's consent to change to the same method of accounting provided in the final regulations to which the taxpayer previously made the unauthorized change only if the taxpayer changes back to its prior method of accounting for the item (*i.e.*, the method of accounting used for the item prior to making the unauthorized change for the item) by amending its federal income tax returns for all of the preceding taxable years in which the unauthorized method was used.

(6) A taxpayer filing one or more amended returns pursuant to section 4.03(3), (4), or (5) of this revenue procedure must file the amended returns before, or at the same time as, the taxpayer files a Form 3115 under this revenue procedure (including the copy of Form 3115 filed with the national office under section 4.01(3) of this revenue procedure) for the taxpayer's first taxable year ending on or

after December 31, 2003. For this purpose, a taxpayer under examination will be considered to have filed an amended return by providing the amended return to the examining agent.

(7) In accordance with § 1.446–1(e)(3)(ii) and Rev. Rul. 90–38, consent is hereby granted for a taxpayer described in section 3.01 of this revenue procedure that also is described in section 4.03(2)(a)(i) or (b) of this revenue procedure to file the amended returns referred to in section 4.03(3) or (5) of this revenue procedure to retroactively change its method of accounting. This consent is granted for the taxable year for which the taxpayer made the unauthorized change and for any subsequent taxable year affected by the unauthorized change.

SECTION 5. COMPUTATION OF SECTION 481(a) ADJUSTMENT

.01 *In general*. A taxpayer changing a method of accounting under this revenue procedure is required to take into account any applicable § 481(a) adjustment as provided in §§ 1.263(a)–4(p)(3) and 1.263(a)–5(n)(3). As provided in the regulations, the § 481(a) adjustment is computed by taking into account only amounts paid or incurred in taxable years ending on or after January 24, 2002. Thus, the § 481(a) adjustment is computed by taking into account only amounts paid or incurred in the period beginning with the first day of the taxable year that includes January 24, 2002, and ending with December 30, 2003. As a matter of administrative convenience, a taxpayer may report amounts paid or incurred on December 31, 2003, as part of the § 481(a) adjustment. The amount of the § 481(a) adjustment must include (i) as a reduction of taxable income, any amounts paid or incurred in the period beginning with the first day of the taxable year that includes January 24, 2002, and ending with December 30, 2003, that were capitalized under the taxpayer's present method of accounting and are currently deductible under the taxpayer's proposed method of accounting, reduced by the amount of such capitalized costs recovered through amortization or depreciation under the taxpayer's present method of accounting, (ii) as an increase to taxable income, any amounts paid or incurred in the period beginning with the first day of the taxable year that includes January 24, 2002, and ending with December 30, 2003, that were currently deducted under the taxpayer's present method of accounting and are capitalized under the taxpayer's proposed method of accounting, reduced by the amount of capitalized costs that would have been recovered through amortization or depreciation if the taxpayer's proposed method of accounting had been applied in taxable years ending on or after January 24, 2002, and (iii) as an increase or a reduction to taxable income, as appropriate, any other adjustments required as a result of the change in method of accounting. If under its present method of accounting a taxpayer capitalized costs incurred prior to the first taxable year that includes January 24, 2002, the taxpayer must continue to treat amortization or depreciation deductions attributable to those costs in accordance with the taxpayer's present method of accounting. Thus, for example, a taxpayer that files returns on a calendar year basis continues to amortize or depreciate in 2004 an intangible created in 2001, even though the taxpayer has changed to a method of accounting provided in the final regulations under which the entire cost of the intangible would be currently deductible if incurred in 2004.

.02 *Reporting the section 481(a) adjustment on Form 3115*.

(1) *Netting*. For purposes of determining the adjustment period under section 2.05(2) of Rev. Proc. 2002–9, the § 481(a) adjustment is determined separately for each change in method of accounting being made under this revenue procedure. Thus, a positive adjustment attributable to a change in one method may not be netted against a negative adjustment attributable to a change in another method. However, in determining the adjustment attributable to a change in method, a taxpayer must net positive § 481(a) adjustments and negative § 481(a) adjustments resulting from that change in method (*e.g.*, if a taxpayer changes to a method of applying the 12-month rule to prepaid amounts, the taxpayer must net the resulting negative § 481(a) adjustment with the positive § 481(a) adjustment that results from including those amounts in inventory pursuant to the taxpayer's existing § 263A method of accounting for inventory).

(2) *Itemized listing on Form 3115*. The taxpayer must include on Form 3115, Part IV, line 25, the total § 481(a) adjustment for all changes in methods of accounting being made. If the taxpayer is making more than one change in method of accounting under the final regulations, the taxpayer must include on an attachment to Form 3115 —

(a) the information required by Part IV, line 25 for each change in method of accounting (including the amount of the § 481(a) adjustment for each change in method of accounting);

(b) the information required by Part II, line 12 of Form 3115 that is associated with each change; and

(c) the citation to the paragraph of the final regulations that provides for each proposed method of accounting (*e.g.*, § 1.263(a)–4(d)(6) or § 1.263(a)–4(f)).

.03 *Examples*. The following examples illustrate the computation of the § 481(a) adjustment under this revenue procedure:

Example 1: Y, a calendar year taxpayer that uses the accrual method of accounting, is a service provider not required to maintain inventories. Y incurred and capitalized $100x in taxable year 2001, $200x in taxable year 2002, and $250x in taxable year 2003. No portion of the $250x was incurred on December 31, 2003. The $100x, $200x, and $250x capitalized and depreciated by Y in 2001, 2002, and 2003 all relate to the same method of accounting and would be currently deductible under the final regulations if the amounts had been incurred on or after December 31, 2003. Y claimed a depreciation deduction of $10x in each of the taxable years 2001, 2002, and 2003 with respect to the $100x incurred and capitalized in 2001, a depreciation deduction of $20x in each of the taxable years 2002 and 2003 with respect to the $200x incurred and capitalized in 2002, and a depreciation deduction of $25x in taxable year 2003 with respect to the $250x incurred and capitalized in 2003. For taxable year 2003, Y may apply for an automatic change in method of accounting with respect to the method under which the amounts had been capitalized. Y's section 481(a) adjustment is a decrease in income of $385x ($160x relating to amounts capitalized in 2002 ($200x - $40 ($20 for 2002 and $20 for 2003)) + $225x relating to amounts capitalized in 2003 ($250x - $25x)). Y must continue to use its present method of accounting for the amount capitalized in 2001.

Example 2: The same facts as Example 1, except Y also incurs $25x of expenses on December 31, 2003, that were previously required to be capitalized but may now be currently deducted under the final regulations. Y may deduct the $25x currently on its federal tax return for 2003 or add it to the $385x calculated as its § 481(a) adjustment. Y's year of change is still 2003.

SECTION 6. TRANSITION RULES

.01 *General rule for previously filed applications*. If a taxpayer within the scope of this revenue procedure has filed a Form 3115 (including a copy of Form 3115 filed with the national office in advance of filing the taxpayer's federal income tax return) to change to a method of accounting provided in the final regulations for its first taxable year ending on or after December 31, 2003, and the Form 3115 does not comply with the provisions of this revenue procedure, the taxpayer will not be considered to have filed the Form 3115 pursuant to the automatic change in method of accounting procedures referred to in §§ 1.263(a)–4(p) and 1.263(a)–5(n) of the final regulations. The taxpayer may file a new Form 3115 that does comply with this revenue procedure, provided the new Form 3115 is filed within the timely filing requirements of section 6.02(3)(a) of Rev. Proc. 2002–9, including the period described in section 6.02(3)(b)(i) of Rev. Proc. 2002–9. This new Form 3115 must be labeled at the top: "Corrected Form 3115 Filed Under Rev. Proc. 2004–23".

.02 *Limited relief for certain previously filed applications*. Notwithstanding section 6.01 of this revenue procedure, if a taxpayer within the scope of this revenue procedure has filed a Form 3115 prior to April 26, 2004, to change to a method of accounting provided in the final regulations for the taxpayer's first taxable year ending on or after December 31, 2003, the taxpayer is not required to file a new Form 3115 under section 6.01 of this revenue procedure for the same change in method of accounting included in the Form 3115 filed prior to April 26, 2004, if the taxpayer:

(1) prepares a written statement signed under penalties of perjury that includes all of the information necessary to comply with this revenue procedure for the same change in method of accounting included in the Form 3115 filed prior to April 26, 2004, (without regard to section 4.02(1) of this revenue procedure) that was not included in the original filing;

(2) submits the written statement, with an attached copy of page 1 of the original Form 3115 filed by the taxpayer, to the national office at the special address provided in section 4.01(3) of this revenue procedure, within the timely filing requirements of section 6.02(3)(a) of Rev. Proc. 2002–9, including the period described in section 6.02(3)(b)(i) of Rev. Proc. 2002–9;

(3) attaches the written statement and a copy of the original Form 3115 to the taxpayer's federal income tax return for the taxpayer's—

(i) first taxable year ending on or after December 31, 2003, or

(ii) second taxable year ending on or after December 31, 2003, if the taxpayer prior to April 26, 2004, has filed the taxpayer's federal income tax return for the taxpayer's first taxable year ending on or after December 31, 2003, that includes a Form 3115, a copy of which also has been filed with the national office, and the § 481(a) adjustment included on that return was computed correctly as described in section 5 of this revenue procedure; and

(4) except as provided in subsections (1), (2), and (3) of this section 6.02, complies with all other provisions of this revenue procedure.

.03 *Special rule regarding amended returns filed pursuant to section 4.03(3), (4), and (5)*. A taxpayer within the scope of this revenue procedure that files one or more amended returns pursuant to section 4.03(3), (4), or (5) of this revenue procedure must file the amended returns before, or at the same time as, the taxpayer files the written statement described in section 6.02(1) of this revenue procedure.

.04 *Automatic extension of time to file late applications*. If a taxpayer has filed its federal income tax return for its first taxable year ending on or after December 31, 2003, and has not attached a Form 3115 to change its method of accounting for that taxable year to a method provided in the final regulations, or has not attached a Form 3115 that complies with this revenue procedure to change its method of accounting for that taxable year to a method provided in the final regulations, the taxpayer may, as provided in section 6.02(3)(b)(i) of Rev. Proc. 2002–9, obtain an automatic extension of 6 months from the due date of its federal income tax return for the year of change (excluding extensions) to obtain the automatic consent provided by this revenue procedure, provided the taxpayer attaches Form 3115 to an amended return for the year of change and otherwise complies with § 6.02(3)(b)(i) of Rev. Proc. 2002–9.

.05 *Example*. The following example illustrates the transition rules of section 6 of this revenue procedure:

Y corporation, a calendar year taxpayer that uses the accrual method of accounting, made, for the taxable year ending December 31, 2001, an unauthorized change in method of accounting to use the "one-year rule" allowed to the taxpayer in *U.S. Freightways Corp. v. Commissioner*. On January 15, 2004, Y filed a Form 3115, for the taxable year ending December 31, 2003, to change to a method of accounting provided in the final regulations. As described in section 4.03(1) of this revenue procedure, Y made an unauthorized change in method of accounting to a method of accounting provided in the final regulations for a taxable year for which the due date of the federal income tax return (including extensions, regardless of whether such extension is automatic and whether or not actually requested) is after January 24, 2002. Y is eligible to use the automatic consent procedures provided in this revenue procedure to obtain the Commissioner's consent to change to a method of accounting provided in the final regulations only if Y changes back to its prior method of accounting for expenses that were deducted under the "one-year rule" by amending its federal income tax returns for its 2001 and 2002 taxable years. In accordance with section 6.01 of this revenue procedure, Y must file by September 15, 2004, a new Form 3115 for the taxable year ending December 31, 2003, that complies with this revenue procedure, including the requirement under section 4.02(6) of this revenue procedure that Y attach a written statement signed under penalties of perjury confirming that Y has filed amended returns pursuant to section 4.03 of this revenue procedure. Alternatively, in lieu of filing a new Form 3115, Y may comply with the requirements of section 6.02 of this revenue procedure by preparing and filing the written statement described in section 6.02 of this revenue procedure that includes all of the information necessary to comply with this revenue procedure for the same change in method of accounting included in the Form 3115 that was not included in the original filing (including the requirement that Y include a written statement signed under penalties of perjury that Y has filed amended returns pursuant to section 4.03 of this revenue procedure).

SECTION 7. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 2002–9 is modified and amplified to include these automatic changes in method of accounting in section 3 of the APPENDIX.

.02 Announcement 93–60, 1993–16 I.R.B. 9, is obsoleted.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for a taxpayer's first taxable year ending on or after December 31, 2003.

SECTION 9. DRAFTING INFORMATION

The principal author of this revenue procedure is Grace Matuszeski of the Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, call Ms. Matuszeski at (202) 622–7900 (not a toll-free call).

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26 CFR 601.601: Rules and regulations.
(Also, Part I, §§ 25, 103, 143; 1.25–4T, 1.103–1, 6a.103A–2.)

Rev. Proc. 2004–24

SECTION 1. PURPOSE

This revenue procedure provides guidance with respect to the United States and area median gross income figures that are to be used by issuers of qualified mortgage bonds, as defined in § 143(a) of the Internal Revenue Code, and issuers of mortgage credit certificates, as defined in § 25(c), in computing the housing cost/income ratio described in § 143(f)(5).

SECTION 2. BACKGROUND

.01 Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any state or local bond. Section 103(b)(1) provides that § 103(a) shall not apply to any private activity bond that is not a qualified bond (within the meaning of § 141). Section 141(e) provides that the term "qualified bond" includes any private activity bond that (1) is a qualified mortgage bond, (2) meets the applicable volume cap requirements under § 146, and (3) meets the applicable requirements under § 147.

.02 Section 143(a)(1) provides that the term "qualified mortgage bond" means a bond that is issued as part of a "qualified mortgage issue". Section 143(a)(2)(A) provides that the term "qualified mortgage issue" means an issue of one or more bonds by a state or political subdivision thereof, but only if (i) all proceeds of the issue (exclusive of issuance costs and a reasonably required reserve) are to be used to finance owner-occupied residences; (ii) the issue meets the requirements of subsections (c), (d), (e), (f), (g), (h), (i), and (m)(7) of § 143; (iii) the issue does not meet the private business tests of paragraphs (1) and (2) of § 141(b); and (iv) with respect to amounts received more than 10 years after the date of issuance, repayments of $250,000 or more of principal on financing provided by the issue are used not later than the close of the first semi-annual period beginning after the date the prepayment (or complete repayment) is received to redeem bonds that are part of the issue.

.03 Section 143(f) imposes eligibility requirements concerning the maximum income of mortgagors for whom financing may be provided by qualified mortgage bonds. Section 25(c)(2)(A)(iii)(IV) provides that recipients of mortgage credit certificates must meet the income requirements of § 143(f). Generally, under §§ 143(f)(1) and 25(c)(2)(A)(iii)(IV), these income requirements are met only if all owner-financing under a qualified mortgage bond and all certified indebtedness amounts under a mortgage credit certificate program are provided to mortgagors whose family income is 115 percent or less of the applicable median family income. Under § 143(f)(6), the income limitation is reduced to 100 percent of the applicable median family income if there are fewer than three individuals in the family of the mortgagor.

.04 Section 143(f)(4) provides that the term "applicable median family income" means the greater of (A) the area median gross income for the area in which the residence is located, or (B) the statewide median gross income for the state in which the residence is located.

.05 Section 143(f)(5) provides for an upward adjustment of the income limitations in certain high housing cost areas. Under § 143(f)(5)(C), a high housing cost area is a statistical area for which the housing cost/income ratio is greater than 1.2. The housing cost/income ratio is determined under § 143(f)(5)(D) by dividing (a) the applicable housing price ratio by (b) the ratio that the area median gross income bears to the median gross income for the United States. The applicable housing price ratio is the new housing price ratio (new housing average purchase price for the area divided by the new housing average purchase price for the United States) or the existing housing price ratio (existing housing average area purchase price divided by the existing housing average purchase price for the United States), whichever results in the housing cost/income ratio being closer to 1. This income adjustment applies only to bonds issued, and nonissued bond amounts elected, after December 31, 1988. *See* § 4005(h) of the Technical and Miscellaneous Revenue Act of 1988, 1988–3 C.B. 1, 311 (1988).

.06 The Department of Housing and Urban Development (HUD) has computed the median gross income for the United States, the states, and statistical areas within the states. The income information was released to the HUD regional offices on January 28, 2004, and may be obtained by calling the HUD reference service at 1–800–245–2691. The income information is also available at HUD's World Wide Web site, *http:huduser.org/datasets/il.html*, which provides a menu from which you may select the year and type of data of interest. The Internal Revenue Service annually publishes the median gross income for the United States.

.07 The most recent nationwide average purchase prices and average area purchase price safe harbor limitations were published on March 1, 2004, in Rev. Proc. 2004–18, 2004–9 I.R.B. 529.

SECTION 3. APPLICATION

.01 When computing the housing cost/income ratio under § 143(f)(5), issuers of qualified mortgage bonds and mortgage credit certificates must use $57,500 as the median gross income for the United States. *See* § 2.06 of this revenue procedure.

.02 When computing the housing cost/income ratio under § 143(f)(5), issuers of qualified mortgage bonds and mortgage credit certificates must use the area median gross income figures released by HUD on January 28, 2004. *See* § 2.06 of this revenue procedure.

SECTION 4. EFFECT ON OTHER REVENUE PROCEDURES

.01 Rev. Proc. 2003–29, 2003–1 C.B. 917, is obsolete except as provided in § 5.02 of this revenue procedure.

.02 This revenue procedure does not affect the effective date provisions of Rev. Rul. 86–124, 1986–2 C.B. 27. Those ef-

fective date provisions will remain operative at least until the Service publishes a new revenue ruling that conforms the approach to effective dates set forth in Rev. Rul. 86–124 to the general approach taken in this revenue procedure.

SECTION 5. EFFECTIVE DATES

.01 Issuers must use the United States and area median gross income figures specified in section 3 of this revenue procedure for commitments to provide financing that are made, or (if the purchase precedes the financing commitment) for residences that are purchased, in the period that begins on January 28, 2004, and ends on the date when these United States and area median gross income figures are rendered obsolete by a new revenue procedure.

.02 Notwithstanding section 5.01 of this revenue procedure, issuers may continue to rely on the United States and area median gross income figures specified in Rev. Proc. 2003–29 with respect to bonds originally sold and nonissued bond amounts elected not later than May 19, 2004, if the commitments or purchases described in § 5.01 are made not later than July 18, 2004.

DRAFTING INFORMATION

The principal author of this revenue procedure is David White of the Office of Assistant Chief Counsel (Exempt Organizations/Employment Tax/Government Entities). For further information regarding this revenue procedure, contact Mr. White at (202) 622–3980 (not a toll-free call).

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26 CFR 601.201: Rulings and determination letters. (Also, Part I, §§ 401; 1.401(b)–1.)

Rev. Proc. 2004–25

SECTION 1. PURPOSE

This revenue procedure extends the remedial amendment period under § 401(b) of the Internal Revenue Code with respect to certain disqualifying provisions until the end of the remedial amendment period for the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107–16, (EGTRRA). This extension applies to all disqualifying provisions of new plans, that is, plans that have been put into effect after December 31, 2001, and to all disqualifying provisions arising from a plan amendment adopted after December 31, 2001.

SECTION 2. BACKGROUND

.01 Section 401(b) provides a remedial amendment period during which an amendment to a disqualifying provision may be made retroactively effective, under certain circumstances, to comply with the requirements of § 401(a). Section 1.401(b)–1(b)*(1)* of the Income Tax Regulations provides that a disqualifying provision includes a provision of a new plan, the absence of a provision from a new plan, or an amendment to an existing plan which causes the plan to fail to satisfy the requirements of the Code applicable to the qualification of the plan as of the date the plan or amendment is first made effective.

.02 As provided in § 1.401(b)–1(d), the remedial amendment period for a disqualifying provision described in § 1.401(b)–1(b)*(1)* begins, in the case of a provision of, or absence of a provision from, a new plan, on the date the plan is put into effect, and, in the case of an amendment to an existing plan, on the date the plan amendment is adopted or put into effect (whichever is earlier). Generally, the remedial amendment period for a disqualifying provision described in § 1.401(b)–1(b)*(1)* ends with the due date (including extensions) for filing the income tax return for the employer's tax year that includes, in the case of a provision of, or absence of a provision from, a new plan, the date the plan is put into effect, or, in the case of an amendment to an existing plan, the date the plan amendment is adopted or put into effect (whichever is later). Section 1.401(b)–1(f) grants the Commissioner the discretion to extend the remedial amendment period.

.03 Section 1.401(b)–1(b)*(3)* provides that the Commissioner may also designate as a disqualifying provision under § 401(b) a plan provision that either (1) results in the failure of the plan to satisfy the qualification requirements of the Code by reason of a change in those requirements, or (2) is integral to a qualification requirement that has been changed. Pursuant to this authority, Notice 2001–42, 2001–2 C.B. 70, provides a remedial amendment period under § 401(b), ending no earlier than the end of the 2005 plan year, in which any needed retroactive remedial plan amendments for EGTRRA must be adopted (the EGTRRA remedial amendment period). The availability of the EGTRRA remedial amendment period is conditioned on the timely adoption of required good faith EGTRRA plan amendments. In general, a good faith EGTRRA plan amendment is adopted timely if it is adopted by the later of the end of the plan year that includes the effective date of the EGTRRA change or the end of the plan's GUST remedial amendment period.[1]

SECTION 3. EXTENSION OF REMEDIAL AMENDMENT PERIOD FOR DISQUALIFYING PROVISIONS AFTER DECEMBER 31, 2001

.01 The remedial amendment period with respect to disqualifying provisions described in § 1.401(b)–1(b)(*1*) that are put into effect (in the case of new plans) or adopted (in the case of existing plans) after December 31, 2001, is extended to the end of the EGTRRA remedial amendment period. Thus, the remedial amendment period with respect to all disqualifying provisions of new plans, that is, plans that have been put into effect after December 31, 2001, and all plan amendments adopted after December 31, 2001, that would cause an existing plan to become disqualified, will not end earlier than the EGTRRA remedial amendment period.

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[1] The term "GUST" refers to the following:

- the Uruguay Round Agreements Act, Pub. L. 103–465;
- the Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103–353;
- the Small Business Job Protection Act of 1996, Pub. L. 104–188;
- the Taxpayer Relief Act of 1997, Pub. L. 105–34;
- the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105–206; and
- the Community Renewal Tax Relief Act of 2000, Pub. L. 106–554.

The GUST remedial amendment period generally ended on the later of February 28, 2002, or the end of a plan's 2001 plan year. However, for certain plans eligible for an extended GUST remedial amendment period under Rev. Proc. 2000–20, 2000–1 C.B. 553, the period generally ended on September 30, 2003.

.02 The time by which good faith EGTRRA plan amendments must be adopted is not extended. Thus, for example, in the case of an individually designed plan that was put into effect during 2002, if the required EGTRRA good faith amendments were adopted by the due date (including extensions) for filing the employer's 2002 income tax return (assuming a calendar plan and tax year), the remedial amendment period for all disqualifying provisions of the plan, whether or not related to EGTRRA, will end no earlier than the end of the plan's 2005 plan year.

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective April 19, 2004.

DRAFTING INFORMATION

The principal author of this revenue procedure is James Flannery of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue procedure, please contact the Employee Plans' taxpayer assistance telephone service at 1–877–829–5500 (a toll-free number), between the hours of 8:00 a.m. and 6:30 p.m. Eastern time, Monday through Friday. Mr. Flannery may be reached at 1–202–283–9888 (not a toll-free number).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Qualified Zone Academy Bonds; Obligations of States and Political Subdivisions

REG–121475–03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations that amend the final regulations on qualified zone academy bonds. These regulations provide guidance to State and local governments that issue qualified zone academy bonds and to banks, insurance companies, and other taxpayers that hold those bonds. These regulations provide guidance on the maximum term, permissible use of proceeds, and remedial actions for qualified zone academy bonds. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments on this rule must be received by June 24, 2004. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for July 21, 2004, at 10 a.m., must be received by July 12, 2004. Comments on the collection of information should be received by May 25, 2004.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–121475–03), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–121475–03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the IRS Internet site at: *www.irs.gov/regs*. The public hearing will be held in room 7218, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Timothy L. Jones or Zoran Stojanovic, (202) 622–3980; concerning submissions of comments, the hearing, and requests to be placed on the building access list to attend the meeting, Guy R. Traynor, (202) 622–3693 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP; Washington, DC 20224. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collection of information in this proposed regulation is in §1.1397E–1(h). This collection of information is required by the IRS to verify compliance with section 1397E. This information will be used to identify issuers of qualified zone academy bonds that have established a defeasance escrow as a remedial action taken because of failure to satisfy certain requirements of section 1397E. The collection of information is required to obtain or retain a benefit. The likely respondents are states or local governments that issue qualified zone academy bonds.

Estimated total annual reporting burden: 3 hours.

Estimated average annual burden hours per respondent: 30 minutes.

Estimated number of respondents: 6.

Estimated annual frequency of responses: varies.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Section 1397E(a) of the Internal Revenue Code (Code) provides that an eligible taxpayer (within the meaning of section 1397E(d)(6)) that holds a qualified zone academy bond on a credit allowance date is allowed a credit against federal income tax for the taxable year that includes the credit allowance date. In general, a qualified zone academy bond is a bond issued by a State or local government to finance certain eligible public school purposes under section 1397E(d). Section 1397E(b) provides that the amount of the qualified zone academy bond credit equals the product of the credit rate and the face amount of the bond held by the taxpayer on the credit allowance date. Under section 1397E(b)(2), the credit rate is determined by the Treasury Department and equals the percentage that the Department estimates generally will permit the issuance of qualified zone academy bonds without discount and without interest cost to the issuer. Sec-

tion 1397E(f)(1) defines *credit allowance date* as the last day of the one-year period beginning on the date of issuance of the issue and the last day of each successive one-year period thereafter. Under section 1397E(d)(3), the maximum term of a qualified zone academy bond is determined by the Treasury Department and equals the term that the Department estimates will result in the present value of the obligation to repay the principal on the bond being equal to 50 percent of the face amount of the bond.

Section 1397E(g) provides that the amount of the qualified zone academy bond credit allowed to the taxpayer is included in the taxpayer's gross income.

Section 1397E(e) imposes a national limitation on the amount of qualified zone academy bonds that may be issued for each calendar year. The limitation is allocated by the Treasury Department among the states on the basis of their respective populations of individuals below the poverty line.

Temporary regulations (T.D. 8755, 1998–1 C.B. 653 [63 FR 671]) interpreting section 1397E were published on January 7, 1998, and amended on July 1, 1999 (T.D. 8826, 1999–2, C.B. 107 [64 FR 35573]). Final regulations under section 1397E (T.D. 8903, 2000–2 C.B. 352 [65 FR 57732]) (the final regulations) were published on September 26, 2000. This document contains proposed regulations (the proposed regulations) that would amend the final regulations.

Explanation of Provisions

I. *Maximum Term*

Section 1397E(d)(3) provides that the Secretary of the Treasury Department shall determine, during each calendar month, the maximum term for qualified zone academy bonds issued during the following calendar month. Section 1397E(d)(3) states that the maximum term shall be the term that the Secretary estimates will result in the present value of the obligation to repay the principal on the bond being equal to 50 percent of the face amount of the bond. Section 1.1397E–1(d) of the final regulations provides that the maximum term for a qualified zone academy bond is determined under section 1397E(d)(3) by using a discount rate equal to 110 percent of the long-term adjusted applicable federal rate (AFR), compounded semi-annually, for the month in which the bond is issued. The IRS publishes the long-term adjusted AFR each month in a revenue ruling.

Section 1397E(b)(2) provides that the Secretary shall determine, during each calendar month, a credit rate for qualified zone academy bonds issued during the following calendar month. Section 1.1397E–1(b) provides that the Secretary shall determine monthly (or more often as deemed necessary by the Secretary) the credit rate the Secretary estimates generally will permit the issuance of a qualified zone academy bond without discount and without interest cost to the issuer. Notice 99–35, 1999–2 C.B. 26, indicates that, until further notice, the credit rate for a qualified zone academy bond will be published daily by the Bureau of Public Debt on its Internet site for State and Local Government Series securities (*http://www.publicdebt.treas.gov*). Notice 99–35 also provides that the credit rate shall be applied to a qualified zone academy bond on the first day on which there is a binding contract in writing for the sale or exchange of the bond. Notice 99–35 states that the credit rate will be determined by the Treasury Department based on its estimate of the yield on outstanding AA rated corporate bonds of a similar maturity for the business day immediately prior to the date on which there is a binding contract in writing for the sale or exchange of the bond.

Questions have been raised regarding the maximum term of a qualified zone academy bond that is sold in one month and issued in another month. Section 1.1397E–1(d) provides that the maximum term is determined based on the month in which the bond is issued. However, under Notice 99–35, the credit rate for a qualified zone academy bond is determined based on the first day on which there is a binding contract in writing for the sale or exchange of the bond. The credit rate and maximum term should be determined on the same day because the credit rate for a bond depends on its maximum term. Accordingly, the proposed regulations amend §1.1397E–1(d) to provide that the maximum term for a qualified zone academy bond is determined based on the first day on which there is a binding contract in writing for the sale or exchange of the bond.

II. *Use of Proceeds and Remedial Actions*

A. *In general*

Section 1397E(d)(1)(A) provides that a bond issued as part of an issue is a qualified zone academy bond only if, among other requirements, at least 95 percent of the proceeds of the issue are to be used for a qualified purpose with respect to a qualified zone academy established by an eligible local education agency (as defined in section 1397E(d)(4)(B)). Section 1397E(d)(5) defines *qualified purpose*, with respect to any qualified zone academy, as (i) rehabilitating or repairing the public school facility in which such academy is established, (ii) providing equipment for use at such academy, (iii) developing course materials for education to be provided at such academy, and (iv) training teachers and other school personnel in such academy. Section 1397E(d)(4)(A) defines *qualified zone academy* as any public school (or academic program within a public school) that is established by and operated under the supervision of an eligible local education agency to provide education or training below the postsecondary level if: (1) the public school or program is designed in cooperation with business in accordance with section 1397E(d)(4)(A)(i); (2) students in the public school or program will be subject to the same academic standards and assessments as other students educated by the eligible local education agency; (3) the comprehensive education plan of the public school or program is approved by the eligible local education agency; and (4) the public school is located in an empowerment zone or enterprise community (as defined in section 1393), or there is a reasonable expectation (as of the date of issuance of the bonds) that at least 35 percent of the students attending the school or participating in the program will be eligible for free or reduced-cost lunches under the school lunch program established under the Richard B. Russell National School Lunch Act.

B. *Compliance with 95-percent test*

1. In General

Comments have been received requesting guidance on compliance with the 95-percent test in section 1397E(d)(1)(A). The proposed regulations provide that, in general, an issue must satisfy three requirements to comply with section 1397E(d)(1)(A). First, the issuer must reasonably expect, as of the date of issuance of the issue, that at least 95 percent of the proceeds of the issue will be expended with due diligence. Second, the issuer must reasonably expect, as of the date of issuance of the issue, that at least 95 percent of the proceeds of the issue will be used for a qualified purpose with respect to a qualified zone academy for the entire term of the issue (without regard to any redemption provision). Third, except as otherwise provided in the remedial action provisions of the proposed regulations, discussed below, at least 95 percent of the proceeds of the issue must actually be used for a qualified purpose with respect to a qualified zone academy for the entire term of the issue (without regard to any redemption provision). For these purposes, any unspent proceeds are treated as used for a qualified purpose with respect to a qualified zone academy during any period that the issuer reasonably expects that those proceeds will be expended with due diligence for a qualified purpose with respect to a qualified zone academy.

2. Proceeds Expended for Rehabilitation, Repair or Equipment

Section 1397E(d)(5)(A) and (B) provides that the term *qualified purpose* with respect to any qualified zone academy includes rehabilitating or repairing the public school facility in which such academy is established, and providing equipment for use at such academy. The proposed regulations specify that, if proceeds of an issue are expended for a purpose described in section 1397E(d)(5)(A) or (B) with respect to a qualified zone academy, then those proceeds are treated as used for a qualified purpose with respect to the academy during any period after such expenditure that (1) the property financed with those proceeds is used for the purposes of the academy and (2) the academy maintains its status as a qualified zone academy. For this purpose, the retirement from service of financed property due to normal wear or obsolescence does not cause the property not to be used for a qualified purpose with respect to a qualified zone academy.

3. Proceeds Expended to Develop Course Materials or Train Teachers

Section 1397E(d)(5)(C) and (D) provides that the term *qualified purpose* with respect to any qualified zone academy includes developing course materials for education to be provided at such academy, and training teachers and other school personnel in such academy. The proposed regulations provide that, if proceeds of an issue are expended for a purpose described in section 1397E(d)(5)(C) or (D) with respect to a qualified zone academy, then those proceeds are treated as used for a qualified purpose with respect to the academy during any period after such expenditure.

4. Special Rule for Determining Status as Qualified Zone Academy

Section 1397E(d)(4)(A)(iv) provides that a public school (or academic program within a public school) is a qualified zone academy only if, among other requirements, the public school is located in an empowerment zone or enterprise community, or there is a reasonable expectation (as of the date of issuance of the bonds) that at least 35 percent of the students attending the school or participating in the program (as the case may be) will be eligible for free or reduced-cost lunches under the school lunch program established under the Richard B. Russell National School Lunch Act. For purposes of determining whether an issue complies with section 1397E(d)(4)(A)(iv), the proposed regulations provide that a public school is treated as located in an empowerment zone or enterprise community for the entire term of the issue if the public school is located in an empowerment zone or enterprise community on the date of issuance of the issue.

C. *Remedial actions*

1. In General

Comments have been received requesting guidance specifying remedial actions that may be taken to cure a violation of the 95-percent test in section 1397E(d)(1)(A).

The proposed regulations specify two remedial actions that may be taken in certain circumstances if less than 95 percent of the proceeds of an issue is actually used for a qualified purpose with respect to a qualified zone academy. These remedial actions are available only if the issuer reasonably expected on the date of issuance of the issue that: (1) at least 95 percent of the proceeds of the issue would be expended with due diligence; and (2) at least 95 percent of the proceeds of the issue would be used for a qualified purpose with respect to a qualified zone academy for the entire term of the issue (without regard to any redemption provision).

As discussed below, the two remedial actions specified in the proposed regulations are (1) redemption or defeasance of the nonqualified bonds and (2) alternative use of the disposition proceeds. If the applicable requirements are met, the *redemption or defeasance* remedial action is available to cure any failure to satisfy the 95-percent test that was not reasonably expected as of the date of issuance. The *alternative use of disposition proceeds* remedial action applies only to certain dispositions of financed property for cash.

2. Redemption or Defeasance of Nonqualified Bonds

A *redemption or defeasance* remedial action is taken if: (1) all of the nonqualified bonds of the issue (determined by applying the principles of §1.142–2(e)) are redeemed within 90 days after the date on which the failure to properly use proceeds occurs; (2) if any nonqualified bonds of the issue are not redeemed within 90 days after the date on which the failure to properly use proceeds occurs (the unredeemed nonqualified bonds), a defeasance escrow is established for the unredeemed nonqualified bonds within 90 days after the date on which the failure to properly use proceeds occurs; or (3) if the failure to properly use proceeds is a disposition of financed property described in sec-

tion 1397E(d)(5)(A) or (B) and the consideration for the disposition is exclusively cash, all of the disposition proceeds (as defined in §1.141–12(c)(1)) are used within 90 days after the date of the disposition to redeem, or establish a defeasance escrow for, a *pro rata* portion of the nonqualified bonds of the issue.

For proceeds that are not spent, a failure to properly use proceeds occurs on the earlier of: (1) the first date on which the public school (or academic program within the public school) does not constitute a qualified zone academy; and (2) the first date on which the issuer reasonably expects that less than 95 percent of the proceeds of the issue will be expended with due diligence for a qualified purpose with respect to a qualified zone academy. For proceeds that have been spent for rehabilitation, repair or equipment described in section 1397E(d)(5)(A) or (B) with respect to a qualified zone academy, a failure to properly use proceeds occurs on the earlier of: (1) the first date on which the public school (or academic program within the public school) does not constitute a qualified zone academy; and (2) the first date on which an action is taken that causes less than 95 percent of the proceeds of the issue to be used for a qualified purpose with respect to a qualified zone academy. If proceeds have been spent for course materials or training described in section 1397E(d)(5)(C) or (D) with respect to a qualified zone academy, no event subsequent to such expenditure shall constitute a failure to properly use such proceeds.

A defeasance escrow is defined as an irrevocable escrow established to retire bonds on the earliest call date after the date on which the failure to properly use proceeds occurs in an amount that is sufficient to retire the bonds on that call date. At least 90 percent of the weighted average amount in a defeasance escrow must be invested in investments (as defined in §1.148–1(b)), except that no amount in a defeasance escrow may be invested in any investment the obligor (or any person that is a related party with respect to the obligor within the meaning of §1.150–1(b)) of which is a user of proceeds of the bonds. All purchases or sales of an investment in a defeasance escrow must be made at the fair market value of the investment within the meaning of §1.148–5(d)(6).

In addition, the issuer must pay to the United States, at the same time and in the same manner as rebate amounts are required to be paid under §1.148–3 (or at such other time or in such other manner as the Commissioner may prescribe), 100 percent of the investment earnings on amounts in the defeasance escrow. For this purpose, the first computation period begins on the date on which the failure to properly use proceeds occurs.

Proceeds of qualified zone academy bonds (other than unspent proceeds of the issue for which the failure to properly use proceeds occurs) are not permitted to be used to redeem or defease the nonqualified bonds. The issuer must provide written notice to the Commissioner of the establishment of the defeasance escrow within 90 days of the date the defeasance escrow is established.

3. Alternative Use of the Disposition Proceeds

The *alternative use of disposition proceeds* remedial action has four requirements. First, the failure to properly use proceeds must be a disposition of financed property described in section 1397E(d)(5)(A) or (B) and the consideration for the disposition must be exclusively cash. Second, the issuer must reasonably expect as of the date of the disposition that: (1) all of the disposition proceeds, plus any amounts received from investing the disposition proceeds, will be expended within two years after the date of the disposition for a qualified purpose with respect to a qualified zone academy; or (2) to the extent not expected to be so expended, used within 90 days after the date of the disposition to take a *redemption or defeasance* remedial action. Third, the disposition proceeds, plus any amounts received from investing the disposition proceeds, must be treated as proceeds for purposes of section 1397E. Fourth, if all of the disposition proceeds, plus any amounts received from investing the disposition proceeds, are not actually expended for a qualified purpose within the two-year period beginning on the date of the disposition (or used within 90 days after the date of the disposition to take a *redemption or defeasance* remedial action), the remainder of such amounts must be used within 90 days after the end of that two-year period for a *redemption or defeasance* remedial action.

D. *Definition of proceeds*

In general, §1.148–1(b) defines sale proceeds as any amounts actually or constructively received from the sale of an issue, including amounts used to pay underwriters' discount or compensation. The proposed regulations provide that, for purposes of the qualified zone academy bond provisions (other than the private business contribution requirement, discussed below), proceeds means sale proceeds as defined in §1.148–1(b), plus any amounts received from investing sale proceeds. Thus, under the proposed regulations, the requirement in section 1397E(d)(1)(A) that at least 95 percent of the proceeds of an issue be used for a qualified purpose with respect to a qualified zone academy is applied by taking into account not only the sale proceeds of the issue, but also any amounts received from investing those sale proceeds.

Section 1397E(d)(1)(C)(ii) provides that a bond is a qualified zone academy bond only if, among other requirements, the issuer certifies that it has written assurances that the private business contribution requirement of section 1397E(d)(2) will be met with respect to the qualified zone academy. Section 1397E(d)(2)(A) provides that the private business contribution requirement is met if the eligible local education agency that established the qualified zone academy has written commitments from private entities to make qualified contributions (as defined in section 1397E(d)(2)(B)) having a present value (as of the date of issuance of the issue) of not less than ten percent of the proceeds of the issue. The proposed regulations provide that, for purposes of the private business contribution requirement of section 1397E(d)(2), proceeds means sale proceeds as defined in §1.148–1(b). Thus, the private business contribution requirement is applied by taking into account only the sale proceeds of the issue without regard to any amounts received or expected to be received from investing those sale proceeds.

E. *Payment of principal, interest or redemption price*

The proposed regulations provide that the use of proceeds of a bond to pay principal, interest or redemption price of the bond or another bond is not a qualified purpose within the meaning of section 1397E(d)(5). Thus, the use of proceeds of a bond to refund another bond is not a qualified purpose. In addition, the use of proceeds of a bond to fund a sinking fund to repay the bond is not a qualified purpose.

Proposed Effective Dates

The proposed regulations are proposed to apply to bonds sold on or after the date that is 60 days after publication of final regulations in the **Federal Register** (the effective date). Issuers may apply the proposed regulations in whole, but not in part, to bonds sold before the effective date, except that: (1) issuers may apply the proposed regulations without regard to §1.1397E–1(h)(8) (relating to the definition of proceeds) to bonds sold before the effective date; and (2) §1.1397E–1(d) (relating to the maximum term of a qualified zone academy bond) and §1.1397E–1(h)(2) (relating to reimbursement of expenditures with proceeds of a qualified zone academy bond) may not be applied to bonds issued before July 1, 1999.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It 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. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. As previously noted, it is estimated that each year only six issuers of qualified zone academy bonds will be required to report the establishment of a defeasance escrow, and the estimated burden of each such reporting is only 30 minutes. In addition, the establishment of a defeasance escrow need only be reported once. Therefore, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments that are submitted timely (preferably a signed original and eight copies) to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for July 21, 2004, at 10 a.m. in room 7218, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the lobby more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who wish to present oral comments at the hearing must submit written comments by June 24, 2004, and submit an outline of the topics to be discussed and the amount of time to be devoted to each topic by July 12, 2004.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Comments are requested on all aspects of the proposed regulations.

Drafting Information

The principal authors of these regulations are Timothy L. Jones and Zoran Stojanovic, Office of Associate Chief Counsel, IRS (Tax Exempt and Governmental Entities), and Stephen J. Watson, Office of Tax Policy, Treasury Department. However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.1397E–1 is amended by

1. Revising the last sentence in paragraph (a).
2. Revising paragraphs (d) and (h).
3. Redesignating the text of paragraph (k) as paragraph (k)(1) and adding a heading for newly designated paragraph (k)(1).
4. Adding paragraph (k)(2).

The revisions and additions read as follows:

§1.1397E–1 Qualified zone academy bonds.

(a) * * * This section also provides other rules for qualified zone academy bonds, including rules governing the credit rate, the private business contribution requirement, the maximum term, use of proceeds, remedial actions, and eligible issuers.

* * * * *

(d) *Maximum term.* The maximum term for a qualified zone academy bond is determined under section 1397E(d)(3) by using a discount rate equal to 110 percent of the long-term adjusted AFR, compounded semi-annually, for the month in which the bond is sold. The Internal Revenue Service publishes this figure each month in a revenue ruling that is published in the Internal Revenue Bulletin. See §601.601(d)(2)(ii)(*b*) of this chapter. A bond is sold on the first day on which there is a binding contract in writing for the sale or exchange of the bond.

* * * * *

(h) *Use of proceeds*—(1) *In general*. Section 1397E(d)(1)(A) provides that a bond issued as part of an issue is a qualified zone academy bond only if, among other requirements, at least 95 percent of the proceeds of the issue are to be used for a qualified purpose with respect to a qualified zone academy established by an eligible local education agency (as defined in section 1397E(d)(4)(B)). Section 1397E(d)(5) defines *qualified purpose*, with respect to any qualified zone academy, as rehabilitating or repairing the public school facility in which such academy is established, providing equipment for use at such academy, developing course materials for education to be provided at such academy, and training teachers and other school personnel in such academy. Section 1397E(d)(4)(A) defines *qualified zone academy* as any public school (or academic program within a public school) that is established by and operated under the supervision of an eligible local education agency to provide education or training below the postsecondary level and that meets the requirements of section 1397E(d)(4)(A)(i), (ii), (iii) and (iv).

(2) *Use of proceeds requirements*. An issue meets the requirements of section 1397E(d)(1)(A) only if—

(i) The issuer reasonably expects, as of the date of issuance of the issue, that—

(A) At least 95 percent of the proceeds of the issue will be expended with due diligence; and

(B) At least 95 percent of the proceeds of the issue will be used for a qualified purpose with respect to a qualified zone academy for the entire term of the issue (without regard to any redemption provision); and

(ii) Except as otherwise provided in paragraph (h)(7) of this section, at least 95 percent of the proceeds of the issue is actually used for a qualified purpose with respect to a qualified zone academy for the entire term of the issue (without regard to any redemption provision).

(3) *Unspent proceeds*. For purposes of paragraphs (h)(2)(i)(B) and (h)(2)(ii) of this section, unspent proceeds are treated as used for a qualified purpose with respect to a qualified zone academy during any period that the issuer reasonably expects that those proceeds will be expended with due diligence for a qualified purpose with respect to a qualified zone academy.

(4) *Proceeds expended for rehabilitation, repair or equipment*—(i) *In general*. Section 1397E(d)(5)(A) and (B) provides that the term *qualified purpose* with respect to any qualified zone academy includes rehabilitating or repairing the public school facility in which such academy is established, and providing equipment for use at such academy. If proceeds of an issue are expended for a purpose described in section 1397E(d)(5)(A) or (B) with respect to a qualified zone academy, then those proceeds are treated as used for a qualified purpose with respect to the academy during any period after such expenditure that—

(A) The property financed with those proceeds is used for the purposes of the academy; and

(B) The academy maintains its status as a qualified zone academy under section 1397E(d)(4).

(ii) *Retirement from service*. The retirement from service of financed property due to normal wear or obsolescence does not cause the property not to be used for a qualified purpose with respect to a qualified zone academy.

(5) *Proceeds expended to develop course materials or train teachers*. Section 1397E(d)(5)(C) and (D) provides that the term *qualified purpose* with respect to any qualified zone academy includes developing course materials for education to be provided at such academy, and training teachers and other school personnel in such academy. If proceeds of an issue are expended for a purpose described in section 1397E(d)(5)(C) or (D) with respect to a qualified zone academy, then those proceeds are treated as used for a qualified purpose with respect to the academy during any period after such expenditure.

(6) *Special rule for determining status as qualified zone academy*. Section 1397E(d)(4)(A)(iv) provides that a public school (or academic program within a public school) is a qualified zone academy only if, among other requirements, the public school is located in an empowerment zone or enterprise community (as defined in section 1393), or there is a reasonable expectation (as of the date of issuance of the bonds) that at least 35 percent of the students attending the school or participating in the program (as the case may be) will be eligible for free or reduced-cost lunches under the school lunch program established under the Richard B. Russell National School Lunch Act. For purposes of determining whether an issue complies with section 1397E(d)(4)(A)(iv), a public school is treated as located in an empowerment zone or enterprise community for the entire term of the issue if the public school is located in an empowerment zone or enterprise community on the date of issuance of the issue.

(7) *Remedial actions*—(i) *General rule*. If less than 95 percent of the proceeds of an issue is actually used for a qualified purpose with respect to a qualified zone academy, the issue will be treated as meeting the requirements of section 1397E(d)(1)(A) if the issue met the requirements of paragraph (h)(2)(i) of this section and a remedial action is taken under paragraph (h)(7)(ii) or (iii) of this section.

(ii) *Redemption or defeasance*—(A) *In general*. A remedial action is taken under this paragraph (h)(7)(ii) if the requirements of paragraphs (h)(7)(ii)(B) and (C) of this section are met.

(B) *Retirement of nonqualified bonds*—(*1*) *In general*. The requirements of this paragraph (h)(7)(ii)(B) are met if—

(*i*) All of the nonqualified bonds of the issue (determined by applying the principles of §1.142–2(e)) are redeemed within 90 days after the date on which the failure to properly use proceeds occurs (as determined under paragraph (h)(7)(ii)(D) of this section); or

(*ii*) If any nonqualified bonds of the issue are not redeemed within 90 days after the date on which the failure to properly use proceeds occurs (the unredeemed nonqualified bonds), a defeasance escrow is established for the unredeemed nonqualified bonds within 90 days after the date on which the failure to properly use proceeds occurs.

(*2*) *Special rule for dispositions for cash*. If the failure to properly use proceeds is a disposition of financed property described in section 1397E(d)(5)(A) or (B) and the consideration for the disposition is exclusively cash, the requirements of this paragraph (h)(7)(ii)(B) are met if all of the disposition proceeds (as defined in §1.141–12(c)(1)) are used within 90 days after the date of the disposition to redeem, or establish a defeasance escrow for, a *pro*

rata portion of the nonqualified bonds of the issue.

(*3*) *Definition of defeasance escrow*. For purposes of this section, a defeasance escrow is an irrevocable escrow established to retire bonds on the earliest call date after the date on which the failure to properly use proceeds occurs in an amount that is sufficient to retire the bonds on that call date. At least 90 percent of the weighted average amount in a defeasance escrow must be invested in investments (as defined in §1.148–1(b)), except that no amount in a defeasance escrow may be invested in any investment the obligor (or any person that is a related party with respect to the obligor within the meaning of §1.150–1(b)) of which is a user of proceeds of the bonds. All purchases or sales of an investment in a defeasance escrow must be made at the fair market value of the investment within the meaning of §1.148–5(d)(6).

(C) *Additional rules*—(*1*) *Limitation on source of funding*. Proceeds of qualified zone academy bonds (other than unspent proceeds of the issue for which the failure to properly use proceeds occurs) must not be used to redeem or defease nonqualified bonds under paragraph (h)(7)(ii)(B) of this section.

(*2*) *Rebate requirement*. The issuer must pay to the United States, at the same time and in the same manner as rebate amounts are required to be paid under §1.148–3 (or at such other time or in such other manner as the Commissioner may prescribe), 100 percent of the investment earnings on amounts in a defeasance escrow established under paragraph (h)(7)(ii)(B) of this section. For this purpose, the first computation period begins on the date on which the failure to properly use proceeds occurs under paragraph (h)(7)(ii)(D) of this section.

(*3*) *Notice of defeasance*. The issuer must provide written notice to the Commissioner, at the place designated in §1.150–5(a), of the establishment of the defeasance escrow within 90 days of the date the defeasance escrow is established.

(D) *When a failure to properly use proceeds occurs*—(*1*) *Proceeds not spent*. For proceeds that are not spent, a failure to properly use proceeds occurs on the earlier of—

(*i*) The first date on which the public school (or academic program within the public school) does not constitute a qualified zone academy; and

(*ii*) The first date on which the issuer reasonably expects that less than 95 percent of the proceeds of the issue will be expended with due diligence for a qualified purpose with respect to a qualified zone academy.

(*2*) *Proceeds spent for rehabilitation, repair or equipment*. For proceeds that have been spent for a purpose described in section 1397E(d)(5)(A) or (B) with respect to a qualified zone academy, a failure to properly use proceeds occurs on the earlier of—

(*i*) The first date on which the public school (or academic program within the public school) does not constitute a qualified zone academy; and

(*ii*) The first date on which an action is taken that causes less than 95 percent of the proceeds of the issue to be used for a qualified purpose with respect to a qualified zone academy.

(*3*) *Proceeds spent for course materials or training*. If proceeds have been spent for a purpose described in section 1397E(d)(5)(C) or (D) with respect to a qualified zone academy, no event subsequent to such expenditure shall constitute a failure to properly use such proceeds.

(iii) *Alternative use of disposition proceeds*. A remedial action is taken under this paragraph (h)(7)(iii) if all of the requirements of paragraphs (h)(7)(iii)(A) through (D) are met—

(A) The failure to properly use proceeds (as determined under paragraph (h)(7)(ii)(D) of this section) is a disposition of financed property described in section 1397E(d)(5)(A) or (B) and the consideration for the disposition is exclusively cash;

(B) The issuer reasonably expects as of the date of the disposition that—

(*1*) All of the disposition proceeds (as defined in §1.141–12(c)(1)), plus any amounts received from investing the disposition proceeds, will be expended within two years after the date of the disposition for a qualified purpose with respect to a qualified zone academy; or

(*2*) To the extent not expected to be so expended, used within 90 days after the date of the disposition to redeem or defease bonds in a manner that meets the requirements of paragraph (h)(7)(ii) of this section;

(C) The disposition proceeds, plus any amounts received from investing the disposition proceeds, are treated as proceeds for purposes of section 1397E; and

(D) If all of the disposition proceeds, plus any amounts received from investing the disposition proceeds, are not actually used in the manner described in paragraph (h)(7)(iii)(B) of this section, the remainder of such amounts are used within 90 days after the end of the two-year period described in paragraph (h)(7)(iii)(B)(*1*) of this section for a remedial action that meets the requirements of paragraph (h)(7)(ii) of this section.

(iv) *Allocating disposition proceeds among multiple funding sources*. For purposes of this paragraph (h)(7), if property has been financed with an issue of qualified zone academy bonds and one or more other funding sources, any disposition proceeds from that property are allocated to the issue under the principles of §1.141–12(c)(3).

(8) *Definition of proceeds*—(i) *In general*. Except as provided in paragraph (h)(8)(ii) of this section, for purposes of section 1397E and this section, proceeds means sale proceeds as defined in §1.148–1(b), plus any amounts received from investing sale proceeds.

(ii) *Private business contribution requirement*. For purposes of the private business contribution requirement of section 1397E(d)(2), proceeds means sale proceeds as defined in §1.148–1(b).

(9) *Payment of principal, interest or redemption price*. The use of proceeds of a bond to pay principal, interest or redemption price of the bond or another bond is not a qualified purpose within the meaning of section 1397E(d)(5).

(10) *Reimbursement*. An expenditure for a qualified purpose may be reimbursed with proceeds of a qualified zone academy bond. For this purpose, rules similar to those in §1.150–2 shall apply.

* * * * *

(k)*Effective dates*—(1)*In general*. * * *

(2) *Special effective dates for paragraphs (d) and (h)*—(i) *In general*. Except as otherwise provided in this paragraph (k)(2), paragraphs (d) and (h) of this section apply to bonds sold on or after the date that is 60 days after publication of final regulations in the **Federal Register**.

(ii) *Permissive application*—(A) *In general*. Except as provided in paragraphs (k)(2)(ii)(B) and (C) of this section, issuers may apply paragraphs (d) and (h) of this section in whole, but not in part, to bonds sold before the date that is 60 days after publication of final regulations in the **Federal Register**.

(B) *Definition of proceeds*. Issuers may apply paragraphs (d) and (h) of this section, without regard to the definition of proceeds in paragraph (h)(8) of this section, to bonds sold before the date that is 60 days after publication of final regulations in the **Federal Register**.

(C) *Bonds issued before July 1, 1999*. Paragraphs (d) and (h)(10) of this section may not be applied to bonds issued before July 1, 1999.

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on March 25, 2004, 8:45 a.m., and published in the issue of the Federal Register for March 26, 2004, 69 F.R. 15747)

Notice of Proposed Rulemaking and Notice of Public Hearing

Section 411(d)(6) Protected Benefits

REG–128309–03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations providing guidance on the conditions under which a plan amendment may eliminate or reduce an early retirement benefit, a retirement-type subsidy, or an optional form of benefit (section 411(d)(6)(B) protected benefits) with respect to a participant's benefits attributable to service before the amendment. The proposed regulations would also provide guidance concerning how the notice requirements of section 4980F apply with respect to such plan amendments. These proposed regulations would generally affect plan sponsors of, and participants in, qualified retirement plans. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by June 22, 2004.

Requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for June 24, 2004, at 10 a.m. must be received by June 3, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–128309–03), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–128309–03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically to the IRS Internet site at *www.irs.gov/regs*. The public hearing will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Pamela R. Kinard at (202) 622–6060; concerning submissions of comments, the hearing, and the requests to be placed on the building access list to attend the hearing, contact Guy Traynor, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to 26 CFR parts 1 and 54 under sections 411(d)(6) and 4980F of the Internal Revenue Code (Code) and section 204(g) and (h) of the Employee Retirement Income Security Act of 1974 (ERISA). These proposed regulations, when finalized, would revise Treasury regulations §1.411(d)–3 to reflect changes to section 411(d)(6) made by the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107–16 (115 Stat. 38) (EGTRRA). These proposed regulations would also include rules relating to changes to section 411(d)(6) made by the Retirement Equity Act of 1984, Public Law 98–397 (98 Stat. 1426) (REA). In addition, these proposed regulations would amend §54.4980F–1(b), Q&A–8, relating to the notice requirement for certain plan amendments that reduce early retirement benefits or retirement-type subsidies.

Section 411(d)(6)(A) provides that a plan is treated as not satisfying the requirements of section 411 if the accrued benefit of a participant is decreased by an amendment of the plan, other than an amendment described in section 412(c)(8) of the Code or section 4281 of ERISA. Section 411(a)(7) generally defines the term "accrued benefit" as meaning, for a defined benefit plan, the employee's accrued benefit determined under the plan and, except as provided in section 411(c)(3), expressed in the form of an annual benefit commencing at normal retirement age. Under section 411(c)(3), if an employee's accrued benefit under a defined benefit plan is to be determined as an amount other than an annual benefit commencing at normal retirement age, the employee's accrued benefit is the actuarial equivalent of such benefit.

Section 301(a) of REA amended section 411(d)(6) to add subparagraph (B), which provides that a plan amendment that has the effect of eliminating or reducing an early retirement benefit or a retirement-type subsidy, or eliminating an optional form of benefit, with respect to benefits attributable to service before the amendment is treated as impermissibly reducing accrued benefits. For a retirement-type subsidy, this protection applies only with respect to an employee who satisfies the preamendment conditions for the subsidy (either before or after the amendment). Section 411(d)(6)(B) also authorizes the Secretary to provide, through regulations, that section 411(d)(6)(B) does not apply to any plan amendment that eliminates optional forms of benefit (other than a plan amendment that has the effect of eliminating or reducing an early retirement benefit or a retirement-type subsidy).

On July 11, 1988, final regulations (T.D. 8212, 1988–2 C.B. 83 [53 FR 26050]) under section 411(d)(6) were published in the **Federal Register**. Section 1.411(d)–4, Q&A–1(a), of the Regulations provides that section 411(d)(6) protects certain benefits, to the extent they have accrued, so that such benefits cannot be reduced or eliminated by plan amendment, except to the extent permitted by regulations. Section

1.411(d)–4 provides rules for when a plan may be amended to reduce or eliminate a section 411(d)(6) protected benefit.

Section 4980F of the Code and section 204(h) of ERISA each require that a plan administrator must give notice of a plan amendment to affected plan participants and beneficiaries when the plan amendment provides for a significant reduction in the rate of future benefit accrual or the elimination or significant reduction in an early retirement benefit or a retirement-type subsidy.

Section 645(b)(1) of EGTRRA amended section 411(d)(6)(B) of the Code to direct the Secretary to issue regulations providing that section 411(d)(6)(B) does not apply to any amendment that reduces or eliminates early retirement benefits or retirement-type subsidies that create significant burdens or complexities for the plan and plan participants unless such amendment adversely affects the rights of any participant in a more than *de minimis* manner. Section 645(b)(2) of EGTRRA also amended section 204(g)(2) of ERISA to include a similar directive for purposes of section 204(g) of ERISA, which provides a rule parallel to section 411(d)(6) of the Code.

Under section 101 of Reorganization Plan No. 4 of 1978 (43 FR 47713), the Secretary of the Treasury has interpretive jurisdiction over the subject matter addressed in these regulations for purposes of ERISA, as well as the Code. Further, section 204(g) of ERISA authorizes the Secretary of the Treasury to issue the regulations under section 204(g) of ERISA, relating to the permissible elimination of optional forms of benefit. Thus, these proposed Treasury regulations issued under sections 411(d)(6) and 4980F of the Code apply as well for purposes of section 204(g) and (h) of ERISA, and respond to the EGTRRA directive for purposes of both section 411(d)(6) of the Code and section 204(g) of ERISA.

In Notice 2002–46, 2002–2 C.B. 96, Treasury and the IRS requested comments regarding the possible approaches for eliminating optional forms of benefit from defined benefit plans, including comments on whether the retention of certain optional forms of benefit under a defined benefit plan results in significant burdens or complexities for plan sponsors and participants, and the conditions under which these optional forms of benefit are of *de minimis* value to plan participants. In Notice 2003–10, 2003–1 C.B. 369, Treasury and the IRS announced that regulations would be proposed to provide general guidance relating to early retirement benefits and retirement-type subsidies under section 411(d)(6)(B). Comments were requested on the guidance that should be provided with respect to early retirement benefits and retirement-type subsidies, as well as whether the proposed regulations should permit plan amendments that eliminate or reduce early retirement benefits or retirement-type subsidies that are contingent on unpredictable events. A number of helpful comments were received in response to these notices and those comments were considered in drafting these proposed regulations.

Explanation of Provisions

General Overview

The proposed regulations would implement the provisions of section 645(b)(1) of EGTRRA by permitting the elimination of early retirement benefits, retirement-type subsidies, and optional forms of benefit under a plan which create significant burdens or complexities for the plan and its participants, but only if the elimination does not adversely affect the rights of any participant in a more than *de minimis* manner. These rules relating to the permissible elimination of section 411(d)(6)(B) protected benefits are in addition to the rules permitting elimination of section 411(d)(6) protected benefits under §1.411(d)–4. These proposed regulations would also include general guidance on section 411(d)(6), including the meaning of terms used therein, the scope of the section 411(d)(6)(A) protection against plan amendments decreasing a participant's accrued benefit, and the scope of the section 411(d)(6)(B) protection for early retirement benefits, retirement-type subsidies, and optional forms of benefit.

Scope of Section 411(d)(6) Protections

The proposed regulations would revise the existing final regulations at §1.411(d)–3. The rules under those regulations would generally be retained but would be updated to reflect statutory changes such as the elimination of class-year vesting and the enactment of section 411(d)(6)(B).

The proposed regulations also would take into account and respond to judicial decisions interpreting section 411(d)(6) (or its parallel provision at section 204(g) of ERISA).[1] For example, the proposed regulations would provide that section 411(d)(6) protection applies to a participant's entire accrued benefit without regard to whether any portion of that accrued benefit is accrued before a participant's severance from employment or is included in the accrued benefit of the participant pursuant to a plan amendment adopted after the participant's severance from employment.[2]

The proposed regulations would retain the rules in the existing regulations that provide that, for purposes of determining whether or not any participant's accrued benefit is decreased, all plan amendments affecting, directly or indirectly, the computation of accrued benefits are taken into account, and that, in determining whether a reduction has occurred, all amendments with the same applicable amendment date (the later of the adoption date or the effective date) are treated as one plan amendment, and would provide that these rules apply to section 411(d)(6)(B) protected benefits as well. Thus, for example, if there are two amendments with the same applicable amendment date, and one amendment increases accrued benefits

[1] See *Bellas v. CBS, Inc.*, 221 F. 3d 517 (3rd Cir. 2000), *cert. denied*, 531 U.S. 1104 (2001) (involuntary separation benefit is both an early retirement benefit and a retirement-type subsidy to the extent it provides for the payment of normal retirement benefits that continue beyond normal retirement age), *Board of Trustees of the Sheet Metal Workers' National Pension Fund v. C.I.R.*, 318 F.3d 599 (4th Cir. 2003) (a COLA benefit granted by a plan amendment is not an accrued benefit for participants that retired before the effective date of the amendment and, thus, the subsequent plan amendment eliminating the COLA benefit did not violate the anti-cutback rule of section 411(d)(6)), *Michael v. Riverside Cement*, 266 F.3d 1023 (9th Cir. 2001) (a plan amendment providing for an actuarial offset of early retirement benefits previously received by a rehire upon subsequent retirement violates ERISA section 204(g), even though the net effect of the amendment is an increase in the early retirement benefit of the participant), and *Heinz v. Central Laborers' Pension Fund*, 303 F.3d 802 (7th Cir. 2002)), *cert. granted*, 72 U.S.L.W. 3370 (U.S. Dec. 1, 2003) (a pension plan offering fully subsidized early retirement benefits violated section 204(g) of ERISA when the plan was amended to expand the definition of disqualifying employment for purposes of applying its suspension of benefits rule).

[2] This is contrary to the analysis in *Board of Trustees of the Sheet Metal Workers' National Pension Fund v. C.I.R.*.

and the other amendment decreases the early retirement factors that are used to determine the early retirement annuity, the amendments are treated as one amendment and only violate section 411(d)(6) if the net dollar amount of the early retirement annuity after the two amendments is lower at any point in time than it would have been without the two amendments.[3]

The proposed regulations would also provide that a plan amendment violates the requirements of section 411(d)(6) if it is one of a series of plan amendments made at different times that, when taken together, have the effect of reducing or eliminating a section 411(d)(6) protected benefit in a manner that would otherwise be prohibited if accomplished through a single amendment. The proposed regulations, however, do not address the interaction of the vesting rules in section 411(a) with section 411(d)(6). This topic, which is currently before the Supreme Court in *Central Laborers' Pension Fund v. Heinz*, No. 02–891, is instead reserved for future guidance.

The proposed regulations also provide a number of clarifications regarding section 411(d)(6)(B) protected benefits. The proposed regulations would clarify that, if a plan amendment merely replaces an optional form of benefit with another optional form of benefit that is of inherently equal or greater value, the amendment is not to be treated as eliminating an optional form of benefit, or eliminating or reducing an early retirement benefit or retirement-type subsidy. For example, a change in the method of calculating a joint and survivor annuity from using a 90% adjustment factor on account of the survivorship payment at particular ages on the annuity starting date to using a 91% adjustment factor at the same ages on the annuity starting date is not treated as an elimination of an optional form of benefit.

The proposed regulations would reflect the rules in the existing regulation §1.411(d)–4, Q&A–1(d), that ancillary benefits, other rights or features, and any other benefits not described in section 411(d)(6) are not benefits protected under section 411(d)(6). The definitions of optional form of benefit, ancillary benefit, and other right or feature have been drawn from the definitions in §1.401(a)(4)–4. In addition the proposed regulations would provide a definition of early retirement benefit, retirement-type benefit, and retirement-type subsidy. See the discussion in this preamble under the heading *Retirement-Type Subsidies and Contingent-Event Benefits*.

Permitted Elimination of Benefits that are Burdensome or Complex and of De Minimis Value to Participants

Section 411(d)(6)(B) of the Code, as amended by EGTRRA, directs the Secretary to issue regulations providing that section 411(d)(6)(B) does not apply to any amendment that reduces or eliminates benefits or subsidies that create significant burdens or complexities for the plan and plan participants unless such amendment adversely affects the rights of any participant in a more than *de minimis* manner.

The EGTRRA Conference Report provides that it is intended that the factors to be considered in determining whether a plan amendment has more than a *de minimis* adverse effect on any participant will include: (1) all of the participant's early retirement benefits, retirement-type subsidies, and optional forms of benefit that are reduced or eliminated by the amendment; (2) the extent to which early retirement benefits, retirement-type subsidies, and optional forms of benefit in effect with respect to a participant after the amendment's effective date provide rights that are comparable to the rights that are reduced or eliminated by the plan amendment; (3) the number of years before the participant attains normal retirement age under the plan (or early retirement age, as applicable); (4) the size of the participant's benefit that is affected by the plan amendment, in relation to the amount of the participant's compensation; and (5) the number of years before the plan amendment is effective. H.R. Conf. Rep. 107–84, at 254 (2001).

The proposed regulations would generally permit an employer to eliminate a section 411(d)(6)(B) protected benefit if the eliminated optional form of benefit is redundant with respect to a retained optional form of benefit. Additional rules would apply to an amendment that, in addition to eliminating an optional form of benefit, also eliminates an early retirement benefit or a retirement-type subsidy. Alternatively, an employer would be permitted to eliminate a section 411(d)(6)(B) protected benefit if the plan amendment was not effective for benefits that begin in the next four years and certain core options are made available to plan participants.

The concepts of allowing an employer to eliminate a redundant optional form of benefit and allowing an employer to eliminate all optional forms of benefit that fall outside a list of core optional forms of benefit were included in suggestions made by commentators who suggested that the elimination of an optional form of benefit would not adversely affect the right of a plan participant in more than a *de minimis* manner as long as the plan offers other optional forms of benefit that are sufficiently similar to the eliminated optional form of benefit. These concepts also reflect factors identified in the legislative history (*e.g.*, the extent to which section 411(d)(6)(B) protected benefits that are available to a participant after the amendment's effective date provide rights that are comparable to the rights of section 411(d)(6)(B) protected benefits that are reduced or eliminated by the plan amendment).

The Treasury and IRS also received comments from practitioners suggesting that the proposed regulations provide a utilization test, which would permit the elimination of an optional form of benefit if the employer can show that the benefit has been utilized rarely by plan participants. These commentators suggested that the lack of utilization is compelling evidence that the elimination of the optional form of benefit would not adversely affect the rights of any plan participant in more than a *de minimis* manner. The Treasury and IRS did not include a utilization test in the proposed regulations because of, among other reasons, the difficulty in applying a utilization standard in situations where there are few retirements (*e.g.*, a small plan).

Under the proposed regulations, the determination of whether the optional forms of benefit that remain after an amendment are sufficiently similar to an eliminated optional form of benefit such that its elimination would not adversely affect the rights of any plan participant in more than a *de*

[3] This is contrary to the analysis in *Michael v. Riverside Cement*.

minimis manner depends on a number of factors. These factors include the extent to which the remaining optional forms of benefit provide the same essential characteristics as the eliminated optional form of benefit; whether the remaining optional forms of benefit are available on the same date and are actuarially equivalent to the eliminated optional form of benefit; and the period of time before the eliminated optional form of benefit could have commenced.

The rules in the proposed regulations would require any amendment eliminating an optional form of benefit to have a delayed effective date. This requirement reflects some of the relevant factors listed in the legislative history (*i.e.*, the number of years until the participant reaches retirement age and the number of years until the amendment is effective). A participant's expectations as to which optional forms of benefit will be available are more settled for a participant who is closer to commencing benefits. Therefore, whether any remaining optional form of benefit is sufficiently similar to an eliminated optional form of benefit so that the substitution of one for the other does not adversely affect the right of a plan participant in more than a *de minimis* manner depends in part on how far in the future the participant is expecting to commence benefits.

The Treasury and IRS believe that the proposed regulations would assist plans that have accumulated numerous optional forms of benefits by simplifying plan administration and reducing plan complexity for participants. At the same time, the proposed regulations would continue to protect the rights of plan participants by not permitting plan amendments that eliminate or reduce an early retirement benefit or a retirement-type subsidy by more than a *de minimis* amount and by protecting the right to elect an optional form of benefit that is most advantageous for a participant with substandard mortality (through inclusion of that form of benefit as a required core option). The rule regarding multiple amendments, discussed above, would preclude the adoption of a series of amendments that, when taken together, constitute an impermissible elimination of a section 411(d)(6)(B) protected benefit. This rule would apply, for example, if a series of amendments were adopted that eliminated a benefit of more than *de minimis* value when considered together, even though each amendment by itself eliminated a benefit of *de minimis* value.

Elimination of Redundant Optional Forms of Benefit

The proposed regulations would provide that a plan may be amended to eliminate an optional form of benefit for a participant with respect to benefits attributable to service before the applicable amendment date if the optional form of benefit is redundant with respect to a retained optional form of benefit and certain other conditions are satisfied. An optional form of benefit is considered redundant with respect to a retained optional form of benefit if the retained optional form of benefit is in the same family of optional forms of benefit as the optional form of benefit being eliminated and the participant's rights with respect to the retained optional form of benefit are not subject to materially greater restrictions than applied to the optional form of benefit being eliminated.

Under the proposed regulations, a plan would be permitted to be amended to eliminate a redundant optional form of benefit for a participant (with respect to benefits attributable to service before the applicable amendment date) only if the plan amendment does not apply to an optional form of benefit with an annuity starting date that is earlier than 90 days after the date the amendment is adopted. In addition, in cases in which the retained optional form of benefit for the participant does not commence on the same annuity starting date as the optional form of benefit that is being eliminated, or, as of the applicable amendment date, the actuarial present value of the retained optional form of benefit is less than the actuarial present value of the optional form of benefit being eliminated, the plan amendment would have to satisfy additional conditions described below.

The proposed regulations would describe 6 basic families of optional forms of benefit — the 50% or more joint and contingent family, the below 50% joint and contingent family, the 10 years or less term certain and life annuity family, the greater than 10 years term certain and life annuity family, the 10 years or less level installment family, and the greater than 10 years level installment family. For this purpose, the determination of whether two optional forms of benefit are in one of the 6 basic families is made without regard to certain differences among enumerated additional features, such as the actuarial factors used to determine the amount of benefits under the optional form of benefit, a social security leveling feature, a refund of employee contributions feature, or a retroactive annuity starting date feature.

Under the proposed regulations, not every optional form of benefit will fit within one of the 6 families listed above. For example, a single-sum distribution option will not be in one of the 6 families listed above and, therefore, the right to receive a single-sum distribution cannot be eliminated under the redundancy rule. However, if there are two optional forms of benefit that do not fit within a family listed above and the only differences between those optional forms of benefit are differences that would be disregarded in determining whether two optional forms of benefits are within the same family (*e.g.*, a single-sum distribution option with and without a retroactive annuity starting date feature), the two optional forms of benefit are treated as members of a separate family.

The proposed regulations would provide that the ability to eliminate redundant optional forms of benefits generally would not apply to optional forms of benefit that are core options (as described below). However, an optional form of benefit that is a core option could be eliminated in favor of a similar retained core option (where the only differences between the eliminated optional form of benefit and the retained optional form of benefit are differences that would be disregarded in determining whether the two optional forms of benefits are within the same family).

The proposed regulations would also provide that, to the extent an optional form of benefit that is being eliminated includes either a social security leveling feature or a refund of employee contributions feature, the retained optional form of benefit must also include that feature, and, to the extent that the optional form of benefit that is being eliminated does not include a social security leveling feature or a refund of employee contributions feature, the retained optional form of benefit must not include that feature. Thus, a plan cannot eliminate

an optional form of benefit that includes a refund of employee contributions feature in favor of an optional form of benefit that does not include that feature. Similarly, a plan cannot eliminate an optional form of benefit that includes a social security leveling feature in favor of an optional form of benefit that does not include that feature. However, the plan need not retain social security leveling features that provide for assumed commencement of social security benefits at more than one date.

In addition, the proposed regulations provide that, to the extent an optional form of benefit that is being eliminated is payable without a retroactive annuity starting date feature, the retained optional form of benefit must be payable without that feature. Thus, a plan cannot eliminate an optional form of benefit that is payable without a retroactive annuity starting date feature in favor of an optional form of benefit that is payable only with a retroactive annuity starting date. However, the plan can eliminate an optional form of benefit payable with a retroactive annuity starting date feature in favor of an optional form of benefit that is payable without a retroactive annuity starting date.

Permissible Elimination of Noncore Optional Forms of Benefit Where Core Options are Offered

As an alternative to the redundancy rule, the proposed regulations would allow a plan amendment to eliminate an optional form of benefit for plan participants with respect to benefits attributable to service before the applicable amendment date if: (1) the plan, after the amendment, offers a designated set of core options to plan participants with respect to benefits attributable to service both before and after the amendment; and (2) the amendment does not apply to participants with annuity starting dates less than four years after the date the amendment is adopted.

The core options are defined in the proposed regulations as a straight life annuity, a 75% joint and contingent annuity, a 10-year certain and life annuity, and the most valuable option for a participant with a short life expectancy. The core options were selected to define a minimum set of optional forms of benefit that provide participants with a sufficiently broad set of choices to meet participants' essential needs in a wide range of personal circumstances. The 75% joint and contingent annuity has been chosen as a required core option based on a recommendation from the 1994–1996 report of the Advisory Council on Social Security.[4] In that report, the Council recommended that dependent spousal benefits in Social Security be gradually increased to 75% of the combined benefit that the surviving spouse and decedent spouse were receiving when both of the spouses were alive. This recommendation was based on statistical studies concluding that a retired surviving spouse generally needs to receive at least 75% of the amount that the retired couple was receiving in order for the surviving spouse to maintain his or her standard of living.

The Treasury and IRS received comments emphasizing the importance of ensuring that a core set of options include some forms of distribution that would be particularly valuable to a participant whose life expectancy differs from the life expectancy used by the plan for actuarial adjustments. This includes providing an option of a life annuity (valuable for a participant with an above-average life expectancy) and the importance of retaining a single-sum payment option (or the form providing the largest death benefit) for a participant with a below-average life expectancy, such as a participant who retires due to a mortal illness.

In light of the comments received, the proposed regulations would include in the list of core options the most valuable option for a participant with a short life expectancy. This is defined as the optional form of benefit that is reasonably expected to result in payments that have the largest actuarial present value in the case of a participant who dies shortly after the annuity starting date. The proposed regulations would provide a safe harbor method for determining which optional form of benefit under the plan is the most valuable option for a participant with a short life expectancy. Under this safe harbor method, a plan may treat a single-sum distribution option with an actuarial present value that is not less than the actuarial present value of any optional form of benefit being eliminated as the most valuable option for a participant with a short life expectancy. If a plan does not offer such a single-sum distribution option, the plan may treat a joint and contingent annuity with a continuation percentage of at least as great as the highest continuation percentage available before the amendment as the most valuable option for a participant with a short life expectancy, provided that the continuation percentage is at least 75%. In the event a plan has neither a single-sum distribution option nor a joint and contingent annuity with a continuation percentage of at least 75%, the plan may treat a term certain and life annuity with a term certain period of at least 15 years as the most valuable option for a participant with a short life expectancy.

In addition, an employer would not be permitted to use the core options alternative to eliminate a single-sum distribution. An exception applies for a single-sum distribution option with respect to less than 25% of the participant's accrued benefit as of the date that the single-sum distribution option is eliminated. This protection against elimination of a single-sum distribution option is in addition to any protection that might be afforded such option as the most valuable option for a participant with a short life expectancy.

The proposed regulations also would provide that, to the extent an optional form of benefit being eliminated includes either a social security leveling feature or a refund of employee contributions feature, at least one of the core options must also be available with that feature. In addition, to the extent that an optional form of benefit being eliminated does not include a social security leveling feature or a refund of employee contributions feature, each of the core options must be available without that feature.

As with the redundancy rule, if the core options do not commence on the same annuity starting date as the optional form of benefit that is being eliminated, or, as of the applicable amendment date, the actuarial present value of the core option is less than the actuarial present value of the optional form of benefit being eliminated, the plan amendment would have to satisfy additional conditions described below.

[4] See the Report of the 1994–1996 Advisory Council on Social Security, available at *http://www.ssa.gov/history/reports/adcouncil/report/findings.htm*

Elimination of Early Retirement Benefits and Retirement-Type Subsidies

The proposed regulations would set forth additional requirements that a plan amendment must satisfy if the retained optional form of benefit or each core option does not have the same annuity starting date or has a lower actuarial present value than the optional form of benefit that is being eliminated. Such an amendment would be permitted only if the optional form of benefit creates significant burdens and complexities for the plan and plan participants and the elimination does not adversely affect the rights of any participant in more than a *de minimis* manner. If the additional requirements are satisfied, a plan may be amended to eliminate an optional form of benefit without regard to whether the amendment has the effect of eliminating an early retirement benefit or reducing a retirement-type subsidy. These additional requirements would not apply to an amendment that eliminates an optional form of benefit in a manner that is otherwise permissible under these proposed regulations where both the annuity starting date and the actuarial present value of the retained optional form of benefit are the same as those features of the eliminated optional form of benefit.

The determination of whether a plan amendment eliminates or reduces section 411(d)(6)(B) protected benefits that create significant burdens or complexities for the plan and its participants is based on facts and circumstances. In the case of an amendment that eliminates an early retirement benefit, relevant factors include whether the annuity starting dates under the plan considered in the aggregate are burdensome or complex (*e.g.*, the number of categories of early retirement benefits, whether the terms and conditions applicable to the plan's early retirement benefits are difficult to summarize in a manner that is concise and readily understandable to the average plan participant, and whether those different early retirement benefits were added to the plan as a result of plan mergers, acquisitions, or other business transactions), and whether the effect of the plan amendment is to reduce the number of categories of early retirement benefit. Analogous factors apply in the case of a plan amendment eliminating a retirement-type subsidy or changing actuarial factors.

The proposed regulations would provide a rebuttable presumption for plan amendments that eliminate a set of annuity starting dates or actuarial factors where the annuity starting dates or actuarial factors under the plan considered in the aggregate are burdensome or complex. If this is the case, then elimination of any one item of the relevant category (*i.e.*, annuity starting dates or actuarial factors) is presumed to eliminate section 411(d)(6)(B) protected benefits that create significant burdens or complexities for the plan and its participants. However, if the effect of a plan amendment with respect to a set of optional forms of benefit is merely to substitute one set of annuity starting dates for another set of annuity starting dates (or one set of actuarial factors for another set of actuarial factors), without any reduction in the number of different annuity starting dates (or actuarial factors), then the plan amendment would not be permitted under these regulations.

The generally applicable rules regarding multiple amendments apply to a series of plan amendments that first create burdens and complexities and then later eliminate them. In accordance with these rules, for example, section 411(d)(6)(B) protected benefits are not considered to create burdens and complexities for a plan and its participants if the plan adds a retirement-type subsidy in order to later eliminate another retirement-type subsidy, even if the elimination of the other subsidy would not adversely affect the rights of any plan participant in a more than *de minimis* manner as provided in the regulations.

In the case of a plan amendment eliminating an optional form of benefit under the redundancy rule, the proposed regulations would provide that a plan amendment eliminating the optional form of benefit does not adversely affect the rights of any participant in more than a *de minimis* manner if the retained optional form of benefit has substantially the same annuity starting date as the optional form of benefit that is being eliminated and the actuarial present value of the eliminated optional form of benefit does not exceed the actuarial present value of the retained optional form of benefit by more than a *de minimis* amount. In the case of a plan amendment eliminating an optional form of benefit under the core options rule, the proposed regulations would provide the plan amendment does not adversely affect the rights of any participant in more than a *de minimis* manner if each of the core options is available with substantially the same annuity starting date as the optional form of benefit that is being eliminated and the actuarial present value of the eliminated benefit does not exceed the actuarial present value of any core benefit by more than a *de minimis* amount. For these purposes, the proposed regulations would provide that annuity starting dates are considered substantially the same if they are within six months of each other.

The Conference Report to EGTRRA provides that the intent of the provision authorizing regulations is solely to permit the elimination of early retirement benefits, retirement-type subsidies, or optional forms of benefit that have no more than a *de minimis* effect on any participant but create disproportionate burdens and complexities for a plan and its participants, and provides two examples illustrating this intent. H.R. Conf. Rep. 107–84, at 254–55 (2001). These examples involve a situation in which the acquisition of the employer and subsequent merger of plans results in the maintenance of multiple retirement-type subsidies (including early retirement subsidies) that create disproportionate burdens and complexities for the plan and its participants. Under the first example, for a 25-year-old participant with compensation of $40,000, the Conference Report provides that Treasury regulations could permit the participant's retirement-type subsidy under the plan to be eliminated entirely. For this participant, taking into account all relevant factors, including the value of the benefit, the participant's compensation, and the number of years before eligibility for the subsidy, the participant's subsidy, with a present value of $75, is of *de minimis* value. Under the second example, for a 50-year-old participant with compensation of $40,000, the Conference Report provides that Treasury regulations could permit the participant's retirement-type subsidy with a present value of $10,000 to be replaced with another retirement-type subsidy with a present value of $9,850. The Conference Report provides that the regulations could permit replacement in the retirement-type subsidy

(which reduces the value of the participant's subsidy by $150) because the difference in subsidies is *de minimis*. However, the $10,000 subsidy could not be entirely eliminated. *Id*.

Based on these examples, the proposed regulations would provide that a reduction in actuarial present value is of no more than a *de minimis* amount (and hence, the rights of any participant are not adversely affected in a more than *de minimis* manner) if the reduction does not exceed the greater of 2% of the present value of the retirement-type subsidy under the eliminated optional form of benefit (if any) prior to the amendment or 1% of the participant's compensation for the prior plan year (as defined in section 415(c)(3)).

In addition to this numerical test, the proposed regulations would provide a *de minimis* test relating to changes in early retirement and other actuarial adjustment factors. Under this rule, the elimination of an optional form of benefit does not adversely affect the rights of any participant in more than a *de minimis* manner if the amendment does not apply to an annuity starting date before the end of the expected transition period for that optional form of benefit. The expected transition period for an optional form of benefit is the period by the end of which it is reasonable to expect, taking into account future accruals, that the section 411(d)(6)(B) protected benefit being eliminated would be subsumed by another optional form of benefit if the plan amendment limited the optional form of benefit being eliminated to the participant's benefits attributable to service before the applicable amendment date. The expected transition period is thus based on the expected wearaway period.

For purposes of this expected transition rule, the expected transition period must be determined in accordance with reasonable actuarial assumptions about the future that are likely to result in the longest reasonable expected transition period, such as the assumption that the participant's compensation will not increase and that future accruals will not exceed accruals in recent periods. If the plan is subsequently amended to reduce the rate of future benefit accrual (or otherwise to lengthen the expected transition period) before the end of the previously determined expected transition period, the subsequent plan amendment must provide that the elimination of the optional form of benefit is void (or must provide for the effective date to be further extended to a new expected transition date taking into account the subsequent amendment). In addition, a plan amendment eliminating an optional form of benefit using the expected transition rule must be limited to participants who continue employment through the end of the expected transition period.

Advance Notice to Participants

Section 4980F(e) of the Code and section 204(h) of ERISA require notice of an amendment to an applicable pension plan that either provides for a significant reduction in the rate of future benefit accrual or that eliminates or significantly reduces an early retirement benefit or a retirement-type subsidy. See §54.4980F–1 generally. While §54.4980F–1(b), Q&A–7(b) and 8(c), generally provide that an amendment eliminating an optional form of benefit as permitted under these proposed regulations would not be a significant reduction for which advance notice to participants is required, plan sponsors are reminded that an amendment limiting an early retirement benefit or retirement-type subsidy to service before the applicable amendment date might be a significant reduction in future benefits for which advance notice is required. Accordingly, advance notice may be required for an amendment permitted under these rules.

These regulations include proposed amendments to the section 4980F regulations clarifying that, for purposes of determining whether an amendment reducing a retirement-type subsidy as permitted under the expected transition period rule is a significant reduction for purposes of section 4980F, the amendment is treated in the same manner as an amendment that limits the retirement-type subsidy to benefits that accrue before the applicable amendment date with respect to the participants (and alternate payees) to whom the reduction is reasonably expected to apply. The proposed changes to the section 4980F regulations also include examples illustrating these rules and clarifying that the effective date of the amendment for purposes of section 4980F(e) of the Code and section 204(h) of ERISA is not the same as the effective date of the reduction.

Retirement-Type Subsidies and Contingent-Event Benefits

Since section 411(d)(6)(B) was added to the Code in REA, questions have arisen as to whether a benefit that is contingent on the occurrence of an unpredictable event — such as a plant shutdown — is a retirement-type subsidy and, thus, protected by section 411(d)(6). Some courts have held that an unpredictable contingent-event benefit is protected, while one has held that it is not.[5]

Notice 2003–10 requested comments on anticipated guidance regarding early retirement benefits and retirement-type subsidies under section 411(d)(6)(B). Notice 2003–10 also stated that regulations addressing subsidies provided upon a plant shutdown would be prospective and that relief from disqualification would be provided.

After reviewing the legislative history, the analysis in the relevant cases, and the submissions of the commentators, Treasury and the IRS have concluded that, if a contingent-event benefit is a retirement-type subsidy, the benefit cannot be reduced or eliminated with respect to service prior to the applicable amendment date without violating section 411(d)(6)(B). The proposed regulations would apply this result without regard to whether the contingent event that triggers the payment of the benefit has or has not occurred prior to the amendment. Thus, the proposed regulations would require the protection of contingent-event benefits that provide retirement-type subsidies under section 411(d)(6)(B) even before the occurrence of the contingency.

The rules under the proposed regulations for determining whether a contin-

[5] Compare *Bellas v. CBS, Inc.*, *supra*, at fn. 1; *Richardson v. Pension Plan of Bethlehem Steel Corp.*, 67 F.3d 1462 (9th Cir. 1995), *withdrawn*, 91 F.3d 1312 (9th Cir. 1996), *modified*, 112 F.3d 982 (9th Cir. 1997) (shutdown benefit is a retirement-type subsidy protected under anticutback rule, opinion withdrawn and modified because court later found plan amendment not valid); *Harms v. Cavenham Forest Industries, Inc.*, 984 F.2d 686 (5th Cir.), *cert. denied*, 510 U.S. 944 (1993) (involuntary separation benefit is a retirement-type benefit protected under the anticutback rule); and *Arena v. ABB Power T&D Company, Inc.*, 2003 U.S. Dist. LEXIS 13166, 31 Employee Benefit Cas. (BNA) 1473 (S.D. Ind. July 22, 2003) (plant shutdown benefit is a retirement-type subsidy protected by the anticutback rule because the benefit continues beyond normal retirement age and the amount of the benefit exceeds the actuarially reduced normal retirement benefit); with *Ross v. Pension Plan for Hourly Employees of SKF Industries, Inc.*, 847 F.2d 329 (6th Cir. 1988) (plant shutdown benefit is not a retirement-type subsidy).

gent-event benefit provides a retirement-type subsidy that is protected under section 411(d)(6) or an ancillary benefit that is not protected would be based on the legislative history of REA. The legislative history provides that:

> [T]he term 'retirement-type subsidy' is to be defined by Treasury regulations. The committee intends that under these regulations, a subsidy that continues after retirement is generally to be considered a retirement-type subsidy. The committee expects, however, that a qualified disability benefit, a medical benefit, a social security supplement, a death benefit (including life insurance), or a plant shutdown benefit (that does not continue after retirement age) will not be considered a retirement-type subsidy. The committee expects that Treasury regulations will prevent the recharacterization of retirement-type benefits as benefits that are not protected [under section 411(d)(6)].[6]

The proposed regulations would provide that ancillary benefits are the benefits listed in the legislative history and other similar benefits that do not affect the payment of the accrued benefit. Thus, if the contingent-event benefit is a plant-shutdown benefit that does not continue beyond retirement age, then the proposed regulations would include the benefit in the definition of ancillary benefits and the contingent-event benefit could be reduced or eliminated without violating section 411(d)(6).

By contrast, the proposed regulations would provide that the payment of an accrued benefit in an optional form or the payment of any other benefit that continues after retirement is a retirement-type benefit (provided that it is not in the list of ancillary benefits set forth in the regulations). Thus, the proposed regulations would provide that if the contingent-event benefit continues beyond retirement (and is not in the list of ancillary benefits set forth in the regulations), the contingent-event benefit would be a retirement-type benefit. To the extent that the retirement-type benefit has a present value in excess of the present value of the accrued benefit, the contingent-event benefit provides a retirement-type subsidy that is protected under section 411(d)(6)(B).

Further, in accordance with the legislative history to REA, the regulations would specifically prohibit an amendment that recharacterizes a retirement-type benefit as an ancillary benefit. Thus, for example, a plan cannot be amended to recharacterize any portion of an early retirement subsidy as a social security supplement that is an ancillary benefit. See also §1.411(d)–4, Q&A–2(c), for rules relating to serial amendments.

Proposed Effective Date

These regulations are proposed to be applicable to amendments adopted on or after the date of the publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. These proposed regulations cannot be relied upon until they are adopted in final form. When these regulations are finalized, the IRS, under its general authority in section 7805(b), will not treat a plan as failing to satisfy the requirements of sections 401 and 411 merely because of a plan amendment that eliminates or reduces an early retirement benefit or retirement-type subsidy that is conditioned on the occurrence of an unpredictable contingent event (within the meaning of section 412(l)) if the amendment is adopted and effective prior to the occurrence of the contingent event and prior to the finalization of these proposed regulations.

Special Analyses

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

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The Treasury and IRS specifically request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

Comments are also requested on the following issues:

- Whether there should be additional families of optional forms of benefit besides the six families listed in the redundancy rule at §1.411(d)–3(c)(4);
- Whether the core options, including the specification of the most valuable option for a participant with a short life expectancy, are sufficient to protect the value of benefit distribution options in a broad range of personal circumstances, such as for a participant with substandard mortality;
- Whether the rules in §1.411(d)–3(e) permitting the reduction of present value through changes in actuarial factors are administrable and sufficiently protective of participants' interests;
- Whether the expected transition period rule should be permitted to apply to a participant who severs employment during the expected transition period (and who satisfies the pre-amendment conditions for the optional form of benefit) if the optional form of benefit being eliminated (or a comparable optional form of benefit with at least the same present value) is available before the end of the expected transition period and the former employee receives written notice describing the effect of the amendment before the amendment becomes applicable;
- How to determine whether a benefit, including a contingent-event benefit, continues after retirement (or retirement age);

[6] S. Rep. No. 98–575, at 26 (1984).

- The extent to which plant-shutdown benefits that do not continue after retirement age are permitted to be provided in a qualified plan (*e.g.*, whether such benefits are limited to payments payable before the plan's earliest retirement age or are the benefits limited to amounts that are less than the expected social security benefit or, alternatively, the normal retirement benefit); and

- What other benefits (*e.g.*, involuntary termination benefits) that do not continue after retirement age and which are similar to the benefits listed as ancillary in the legislative history should be considered ancillary and should be permitted to be provided in a qualified plan.

A public hearing has been scheduled for June 24, 2004, beginning at 10 a.m. in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the main entrance, located at 1111 Constitution Avenue, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" portion of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments must submit written or electronic comments and an outline of the topics to be discussed and time to be devoted to each topic (signed original and eight (8) copies) by June 3, 2004. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving comments has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Pamela R. Kinard, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 54 are proposed to be amended as follows:

PART 1—INCOME TAXES

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

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

§1.411(d)–3 also issued under 26 U.S.C. 411(d)(6) and section 645(b) of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107–16 (115 Stat. 38).* * *

Par. 2. Section 1.411(d)–3 is revised to read as follows:

§1.411(d)–3 Section 411(d)(6) protected benefits.

(a) *Protection of accrued benefits*—(1) *General rule*. Under section 411(d)(6)(A), a plan is not a qualified plan (and a trust forming a part of such plan is not a qualified trust) if a plan amendment decreases the accrued benefit of any plan participant, except as provided in section 412(c)(8), section 4281 of the Employee Retirement Income Security Act of 1974 as amended (ERISA), or other applicable law (*e.g.*, section 1541(a)(2) of the Taxpayer Relief Act of 1997 (Public Law 105–34, 111 Stat. 788, 1085)). For purposes of this section, a plan amendment includes any changes to the terms of a plan and includes a plan termination. The protection of section 411(d)(6) applies to a participant's entire accrued benefit without regard to whether any portion of that accrued benefit is accrued before a participant's severance from employment or is included in the accrued benefit of the participant pursuant to a plan amendment adopted after the participant's severance from employment.

(2) *Plan provisions taken into account*—(i) *Direct and indirect reduction in accrued benefit*. For purposes of determining whether or not any participant's accrued benefit is decreased, amendments to all the provisions of a plan affecting, directly or indirectly, the computation of accrued benefits are taken into account. Plan provisions indirectly affecting accrued benefits include, for example, provisions relating to years of service and compensation.

(ii) *Amendments effective on the same applicable amendment date*. In determining whether a reduction in accrued benefit has occurred, all amendments with the same applicable amendment date are treated as one plan amendment. Thus, if there are two amendments with the same applicable amendment date, and one amendment, standing alone, increases benefits and the other amendment, standing alone, decreases benefits, the amendments are treated as one amendment and will only violate section 411(d)(6) if the net effect is to decrease the accrued benefit on that date for any participant.

(iii) *Multiple amendments*. A plan amendment violates the requirements of section 411(d)(6) if it is one of a series of plan amendments made at different times that, when taken together, have the effect of reducing or eliminating a section 411(d)(6) protected benefit in a manner that would be prohibited by section 411(d)(6) if accomplished through a single amendment.

(3) *Application of section 411(a) nonforfeitability provisions with respect to section 411(d)(6) protected benefits*. [Reserved].

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

Example 1. (i) *Facts*. Plan A provides an annual benefit of 2% of career average pay times years of service commencing at normal retirement age (age 65). Plan A is amended on November 1, 2004, effective as of January 1, 2005, to provide for an annual benefit of 1.3% of final pay times years of service, with final pay computed as the average of a participant's highest 3 consecutive years of compensation. As of January 1, 2005, Participant M has 16 years of service, his career average pay is $37,500, and the average of his highest 3 consecutive years of compensation is $67,308. Thus, M's accrued benefit as of the effective date of the amendment is increased from $12,000 per year at normal retirement age (2% times $37,500 times 16 years of service) to $14,000 per year at normal retirement age (1.3% times $67,308 times 16 years of service). As of January 1, 2005, Participant N has 6 years of service, his career average pay is $50,000, and the average of his highest 3 consecutive

years of compensation is $51,282. Participant N's accrued benefit as of the applicable amendment date is decreased from $6,000 per year at normal retirement age (2% times $50,000 times 6 years of service) to $4,000 per year at normal retirement age (1.3% times $51,282 times 6 years of service).

(ii) *Conclusion*. The plan amendment fails to satisfy the requirements of section 411(d)(6)(A) because the amendment decreases the accrued benefit of Participant N below the level of the accrued benefit of Participant N immediately before the applicable amendment date.

Example 2. (i) *Facts*. The facts are the same as *Example 1* except that Plan A includes a provision under which Participant N's accrued benefit cannot be less than what it was immediately before the amendment (so that Participant N's accrued benefit could not be less than $6,000 per year at normal retirement age).

(ii) *Conclusion*. The amendment does not violate the requirements of section 411(d)(6)(A) with respect to Participant N (although Participant N would not accrue any benefits until the point in time at which the new formula amount would exceed the amount payable under the minimum provision, approximately 3 years after the amendment becomes effective).

(b) *Protection of section 411(d)(6)(B) protected benefits*—(1) *General rule*—(i) *Prohibition against plan amendments eliminating or reducing section 411(d)(6)(B) protected benefits.* A plan is treated as decreasing an accrued benefit if it is amended to eliminate or reduce a section 411(d)(6)(B) protected benefit as defined in paragraph (f)(4) of this section, except as provided in this section. This paragraph (b)(1) applies to participants who satisfy (either before or after the plan amendment) the pre-amendment conditions for the section 411(d)(6)(B) protected benefit.

(ii) *Contingent benefits.* The rule of paragraph (b)(1)(i) of this section applies to participants who satisfy (either before or after the plan amendment) the pre-amendment conditions for the section 411(d)(6)(B) protected benefit even if the condition on which the eligibility for the section 411(d)(6)(B) protected benefit depends is an unpredictable event (*e.g.*, a plant shutdown).

(iii) *Application of general rules*. For purposes of determining whether or not any participant's section 411(d)(6)(B) protected benefit is eliminated or reduced, the rules of paragraph (a) of this section apply to section 411(d)(6)(B) protected benefits in the same manner as they apply to benefits described in section 411(d)(6)(A). As an example of the application of paragraph (a)(2)(ii) of this section to section 411(d)(6)(B) protected benefits, if there are two amendments with the same applicable amendment date, and one amendment increases accrued benefits and the other amendment decreases the early retirement factors that are used to determine the early retirement annuity, the amendments are treated as one amendment and only violate section 411(d)(6) if the net dollar amount of the early retirement annuity after the two amendments is lower at any point in time than it would have been without the two amendments. As an example of the application of paragraph (a)(2)(iii) of this section to section 411(d)(6)(B) protected benefits, a series of amendments that, when taken together, have the effect of reducing or eliminating early retirement benefits or retirement-type subsidies in a manner that adversely affects the rights of any participant in more than a *de minimis* manner violates section 411(d)(6)(B) even if each amendment would be permissible pursuant to paragraphs (c) through (e) of this section.

(2) *Permissible elimination of section 411(d)(6)(B) protected benefits*—(i) *In general*. A plan may be amended to eliminate a section 411(d)(6)(B) protected benefit if the elimination is in accordance with section 411(d)(6)(C), (D), or (E), paragraph (c) or (d) of this section, or §1.411(d)–4.

(ii) *Increases in payment amounts do not eliminate an optional form of benefit*. If a plan amendment merely replaces an optional form of benefit with another optional form of benefit that is of inherently equal or greater value (within the meaning of §1.401(a)(4)–4(d)(4)(i)(A)), the amendment is not to be treated as eliminating an optional form of benefit, or eliminating or reducing an early retirement benefit or retirement-type subsidy. Thus, for example, a change in the method of calculating a joint and survivor annuity from using a 90% adjustment factor on account of the survivorship payment at particular ages on the annuity starting date to using a 91% adjustment factor at the same ages on the annuity starting date is not treated as an elimination of an optional form of benefit.

(3) *Permissible elimination of benefits that are not section 411(d)(6) protected benefits*—(i) *In general*. Section 411(d)(6) does not provide protection for benefits that are ancillary benefits, other rights and features, or any other benefits that are not described in section 411(d)(6). See §1.411(d)–4, Q&A–1(d). However, a plan may not be amended to recharacterize a retirement-type benefit as an ancillary benefit. Thus, for example, a plan amendment to recharacterize any portion of an early retirement subsidy as a social security supplement that is an ancillary benefit violates section 411(d)(6).

(ii) *No protection for future benefit accruals*. Section 411(d)(6) only protects benefits that accrue before the applicable amendment date. Thus, a plan may be amended to eliminate or reduce an early retirement benefit, a retirement-type subsidy, or an optional form of benefit with respect to benefits not yet accrued on the applicable amendment date without violating section 411(d)(6). However, section 4980F(e) of the Internal Revenue Code and section 204(h) of ERISA require notice of an amendment to an applicable pension plan that either provides for a significant reduction in the rate of future benefit accrual or that eliminates or significantly reduces an early retirement benefit or a retirement-type subsidy. See §54.4980F–1 of this chapter generally, and see §54.4980F–1(b), Q&A–7(b) and Q&A–8(c), with respect to whether such notice is required for a reduction in an early retirement benefit or retirement-type subsidy permitted under section 411(d)(6)(B).

(c) *Permissible elimination of optional forms of benefit that are redundant*—(1) *General rule*. Except as otherwise provided in paragraph (c)(5) of this section, a plan may be amended to eliminate an optional form of benefit for a participant with respect to benefits accrued before the applicable amendment date if—

(i) The optional form of benefit is redundant with respect to a retained optional form of benefit, within the meaning of paragraph (c)(2) of this section;

(ii) The plan amendment is not applicable with respect to an optional form of benefit with an annuity starting date that is less than 90 days after the date the amendment is adopted; and

(iii) In any case in which the retained optional form of benefit for the participant does not commence on the same annuity starting date as the optional form of benefit that is being eliminated or, as of the applicable amendment date, the actuarial

present value of the retained optional form of benefit for the participant is less than the actuarial present value of the optional form of benefit that is being eliminated, the requirements of paragraph (e) of this section are satisfied.

(2) *Similar types of optional forms of benefit are redundant*—(i) *General rule*. An optional form of benefit is redundant with respect to a retained optional form of benefit if—

(A) The retained optional form of benefit is available to the participant;

(B) The retained optional form of benefit is in the same family of optional forms, within the meaning of paragraphs (c)(3) and (4) of this section, as the optional form of benefit being eliminated; and

(C) A participant's rights with respect to the retained optional form of benefit are not subject to materially greater restrictions (such as conditions relating to eligibility, restrictions on a participant's ability to designate the person who is entitled to benefits following the participant's death, or restrictions on a participant's right to receive an in-kind distribution) than applied to the optional form of benefit being eliminated.

(ii) *Special rule for core options*. An optional form of benefit that is a core option may not be eliminated as a redundant benefit under the rules of this paragraph (c) unless the retained optional form of benefit and the eliminated core option are identical except for differences described in paragraph (c)(3)(ii) of this section. Thus, for example, a particular 10-year certain and life annuity may not be eliminated by plan amendment unless the retained optional form of benefit is another 10-year certain and life annuity.

(3) *Family of optional forms of benefit*—(i) *In general*. Paragraph (c)(4) of this section describes certain families of optional forms of benefits. Not every optional form of benefit that is offered under a plan necessarily fits within a family as described in paragraph (c)(4) of this section. Each optional form of benefit that is not included in any particular family listed in paragraph (c)(4) of this section is in a separate family with other optional forms of benefit that would be identical to that optional form of benefit but for differences that are described in paragraph (c)(3)(ii) of this section.

(ii) *Certain differences among optional forms of benefit*—(A) *Differences in actuarial factors and annuity starting dates*. The determination of whether two optional forms of benefit are within a family of optional forms of benefit is made without regard to the actuarial factors that are used to determine the amount of the distributions under those optional forms of benefit and without regard to annuity starting dates. For example, if a plan has a single-sum distribution option that is calculated using a 5% interest rate and a specific mortality table and another single-sum distribution option that is calculated using the applicable interest rate as defined in section 417(e)(3)(A)(ii)(II) and the applicable mortality table as defined in section 417(e)(3)(A)(ii)(I), both single-sum distribution options are in the same family under the rules of paragraph (c)(3)(i) of this section.

(B) *Differences in social security leveling features, refund of employee contributions features, and retroactive annuity starting date features*. Two optional forms of benefit that are identical except with respect to social security leveling features, refund of employee contributions features, or retroactive annuity starting date features are treated as members of the same family of optional forms of benefit. But see paragraph (c)(5) of this section for special rules relating to social security leveling, refund of employee contributions, and retroactive annuity starting date features in optional forms of benefit.

(4) *List of families*. The following are families of optional forms of benefit for purposes of this paragraph (c):

(i) *Joint and contingent options with continuation percentages of 50% to 100%*. An optional form of benefit is within the 50% or more joint and contingent family if it provides a life annuity to the participant and a survivor annuity to an individual that is at least 50% and no more than 100% of the annuity provided to the participant. An optional form of benefit is within the 50% or more joint and contingent family without regard to whether the form of benefit includes a term certain provision, a pop-up provision (under which payments increase upon the death of the beneficiary or another event that causes the beneficiary not to be entitled to a survivor annuity), or a cash refund feature (under which payment is provided upon the death of the last annuitant in an amount equal to the excess of the present value of the annuity at the annuity starting date over the total of payments before the death of the last annuitant).

(ii) *Joint and contingent options with continuation percentages less than 50%*. An optional form of benefit is within the below 50% joint and contingent family if it provides a life annuity to the participant and a survivor annuity to an individual that is no more than 50% of the annuity provided to the participant. An optional form of benefit is within the below 50% joint and contingent family without regard to whether the form of benefit includes a term certain provision, a pop-up provision (under which payments increase upon the death of the beneficiary or another event that causes the beneficiary not to be entitled to a survivor annuity), or a cash refund feature (under which payment is provided upon the death of the last annuitant in an amount equal to the excess of the present value of the annuity at the annuity starting date over the total of payments before the death of the last annuitant).

(iii) *Term certain and life annuity options with a term of 10 years or less*. An optional form of benefit is within the 10 years or less term certain and life family if it is a life annuity with a guarantee that payments will continue to the participant's designated beneficiary for the remainder of a fixed period that is not in excess of 10 years if the participant dies before the end of the fixed period.

(iv) *Term certain and life annuity options with a term in excess of 10 years*. An optional form of benefit is within the greater than 10 years term certain and life family if it is a life annuity with a guarantee that payments will continue to the participant's designated beneficiary for the remainder of a fixed period that is in excess of 10 years if the participant dies before the end of the fixed period.

(v) *Level installment payment options over a period of 10 years or less*. An optional form of benefit is within the 10 years or less installment family if it provides for substantially level payments to the participant for a fixed period of at least two years with a guarantee that payments will continue to the participant's beneficiary for the remainder of the fixed period not in excess of 10 years if the participant dies before the end of the fixed period.

(vi) *Level installment payment options over a period of more than 10 years*. An optional form of benefit is within the greater than 10 years installment family if it provides for substantially level payments to the participant for a fixed period with a guarantee that payments will continue to the participant's beneficiary for the remainder of a fixed period that is in excess of 10 years if the participant dies before the end of the fixed period.

(5) *Special rules for certain features included in optional forms of benefit*. For purposes of applying this paragraph (c), to the extent an optional form of benefit that is being eliminated includes either a social security leveling feature or a refund of employee contributions feature, the retained optional form of benefit must also include that feature, and to the extent that the optional form of benefit that is being eliminated does not include a social security leveling feature or a refund of employee contributions feature, the retained optional form of benefit must not include that feature. For purposes of applying this paragraph (c), to the extent an optional form of benefit that is being eliminated does not include a retroactive annuity starting date feature, the retained optional form of benefit must not include the feature.

(d) *Permissible elimination of non-core optional forms of benefit where core options are offered*—(1) *General rule*. Except as otherwise provided in paragraph (d)(2) of this section, a plan may be amended to eliminate an optional form of benefit for a participant with respect to benefits attributable to service before the applicable amendment date if—

(i) After the amendment, each of the core options described in paragraph (f)(3) of this section is available to the participant with respect to benefits attributable to service before and after the amendment;

(ii) The plan amendment is not applicable with respect to an optional form of benefit with an annuity starting date that is less than four years after the date the amendment is adopted; and

(iii) In any case in which all of the core options are not available commencing on the same annuity starting date as each optional form of benefit that is being eliminated or, as of the applicable amendment date, the actuarial present value of the benefit payable under any of the core options with the same annuity starting date is less than the actuarial present value of benefits payable under the optional form of benefit that is being eliminated, the requirements of paragraph (e) of this section are satisfied.

(2) *Special rules*—(i) *Treatment of certain features included in optional forms of benefit*. For purposes of applying this paragraph (d), to the extent an optional form of benefit that is being eliminated includes either a social security leveling feature or a refund of employee contributions feature, at least one of the core options must also be available with that feature, and, to the extent that the optional form of benefit that is being eliminated does not include a social security leveling feature or a refund of employee contributions feature, each of the core options must be available without that feature. For purposes of applying this paragraph (d), to the extent an optional form of benefit that is being eliminated does not include a retroactive annuity starting date feature, each of the core options must be available without that feature.

(ii) *Eliminating the most valuable option for a participant with a short life expectancy*. For purposes of applying this paragraph (d), if the most valuable option for a participant with a short life expectancy as described in paragraph (f)(3)(i)(D) of this section is eliminated, then, after the plan amendment, an optional form of benefit that is identical, except for differences described in paragraph (c)(3)(ii) of this section, must be available to the participant. However, such a plan amendment cannot eliminate a refund of employee contributions feature from the most valuable option for a participant with a short life expectancy.

(iii) *Single-sum distributions*. A plan amendment is not treated as satisfying this paragraph (d) if it eliminates an optional form of benefit that includes a single-sum distribution that applies with respect to at least 25% of the participant's accrued benefit as of the date the optional form of benefit is eliminated. But see §1.411(d)–4, Q&A–2(b)(2)(v), relating to involuntary single-sum distributions for benefits with a present value not in excess of the maximum dollar amount in section 411(a)(11).

(e) *Permissible plan amendments under paragraphs (c) and (d) eliminating or reducing section 411(d)(6)(B) protected benefits that are burdensome and of de minimis value*—(1) *In general*. A plan amendment that, pursuant to paragraph (c)(1)(iii) or (d)(1)(iii) of this section, is required to satisfy this paragraph (e) satisfies this paragraph (e) if—

(i) The amendment eliminates section 411(d)(6)(B) protected benefits that create significant burdens or complexities for the plan and its participants as described in paragraph (e)(2) of this section; and

(ii) The amendment does not adversely affect the rights of any participant in a more than *de minimis* manner as described in paragraph (e)(3) of this section.

(2) *Plan amendments eliminating section 411(d)(6)(B) protected benefits that create significant burdens and complexities*—(i) *Facts and circumstances analysis*. The determination of whether a plan amendment eliminates section 411(d)(6)(B) protected benefits that create significant burdens or complexities for the plan and its participants is based on facts and circumstances. In the case of an amendment that eliminates an early retirement benefit, relevant factors include whether the annuity starting dates under the plan considered in the aggregate are burdensome or complex (*e.g.*, the number of categories of early retirement benefits, whether the terms and conditions applicable to the plan's early retirement benefits are difficult to summarize in a manner that is concise and readily understandable to the average plan participant, and whether those different early retirement benefits were added to the plan as a result of plan mergers, acquisitions, or other business transactions), and whether the effect of the plan amendment is to reduce the number of categories of early retirement benefit. Similarly, in the case of a plan amendment eliminating a retirement-type subsidy or changing actuarial factors, relevant factors include whether the actuarial factors used for determining benefit distributions available in otherwise identical forms of benefit under the plan considered in the aggregate are burdensome or complex (*e.g.*, the number of different retirement-type subsidies and other actuarial factors available under the plan, whether the terms and conditions applicable to the plan's retirement-type subsidies are difficult to summarize in a manner that is concise and readily understandable to the average plan participant, and whether those different retirement-type subsidies and other actuarial

factors were added to the plan as a result of plan mergers, acquisitions, or other business transactions), and whether the effect of the plan amendment is to reduce the number of categories of retirement-type subsidies or other actuarial factors.

(ii) *Presumption for certain amendments*. If the annuity starting dates under the plan considered in the aggregate are burdensome or complex, then elimination of any one of the annuity starting dates is presumed to eliminate section 411(d)(6)(B) protected benefits that create significant burdens or complexities for the plan and its participants. However, if the effect of a plan amendment with respect to a set of optional forms of benefit is merely to substitute one set of annuity starting dates for another set of annuity starting dates, without any reduction in the number of different annuity starting dates, then the plan amendment does not satisfy the requirements of paragraph (e) of this section. Similarly, if the actuarial factors used for determining benefit distributions available in otherwise identical forms of benefit under the plan considered in the aggregate are burdensome or complex, then elimination of any one set of actuarial factors is presumed to eliminate section 411(d)(6)(B) protected benefits that create significant burdens or complexities for the plan and its participants. However, if the effect of a plan amendment with respect to a set of optional forms of benefit is merely to substitute one set of actuarial factors for another set of actuarial factors, without any reduction in the number of different actuarial factors, then the plan amendment does not satisfy the requirements of paragraph (e) of this section.

(iii) *Restrictions against creating burdens or complexities*. See paragraph (b)(1)(ii) of this section for general rules applicable to multiple amendments. In accordance with these rules, for example, section 411(d)(6)(B) protected benefits are not considered to create burdens and complexities for a plan and its participants if the plan adds a retirement-type subsidy in order to later eliminate another retirement-type subsidy, even if the elimination of the other subsidy would not adversely affect the rights of any plan participant in a more than *de minimis* manner as provided in paragraph (e)(3) of this section.

(3) *Elimination of early retirement benefits or retirement-type subsidies that are de minimis*—(i) *Rules for retained optional forms of benefit under paragraph (c) of this section*. For purposes of paragraph (c) of this section, the elimination of an optional form of benefit does not adversely affect the rights of any participant in a more than *de minimis* manner if—

(A) The retained optional form of benefit described in paragraph (c) of this section has substantially the same annuity starting date as the optional form of benefit that is being eliminated, as described in paragraph (e)(4) of this section; and

(B) Either the actuarial present value of the benefit payable in the optional form of benefit that is being eliminated does not exceed the actuarial present value of the benefit payable in the retained optional form of benefit by more than a *de minimis* amount, as described in paragraph (e)(5) of this section, or the amendment satisfies the requirements of paragraph (e)(6) of this section relating to a delayed effective date.

(ii) *Rules for core options under paragraph (d) of this section*. For purposes of paragraph (d) of this section, the elimination of an optional form of benefit does not adversely affect the rights of any participant in a more than *de minimis* manner if, with respect to each of the core options—

(A) The core option is available after the amendment with substantially the same annuity starting date as the optional form of benefit that is being eliminated, as described in paragraph (e)(4) of this section; and

(B) Either the actuarial present value of the benefit payable in the optional form of benefit that is being eliminated does not exceed the actuarial present value of the benefit payable under the core option by more than a *de minimis* amount, as described in paragraph (e)(5) of this section, or the amendment satisfies the requirements of paragraph (e)(6) of this section.

(4) *Definition of substantially the same annuity starting dates*. For purposes of applying paragraphs (e)(3)(i)(A) and (ii)(A) of this section, annuity starting dates are considered substantially the same if they are within six months of each other.

(5) *Definition of de minimis difference in actuarial present value*. For purposes of applying paragraphs (e)(3)(i)(B) and (ii)(B) of this section, a difference in actuarial present value between the optional form of benefit being eliminated and the retained optional form of benefit or core option is of no more than a *de minimis* amount if, as of the applicable amendment date, the difference between the actuarial present value of the eliminated optional form of benefit and the actuarial present value of the retained optional form of benefit or core option is not more than the greater of—

(i) 2% of the present value of the retirement-type subsidy under the eliminated optional form of benefit (if any) prior to the amendment; or

(ii) 1% of the participant's compensation for the prior plan year (as defined in section 415(c)(3)).

(6) *Delayed effective date*—(i) *General rule*. For purposes of applying paragraph (e)(3) of this section, an amendment that eliminates an optional form of benefit satisfies the requirements of this paragraph (e)(6) if the elimination of the optional form of benefit is not applicable to any annuity starting date before the end of the expected transition period for that optional form of benefit.

(ii) *Determination of expected transition period*. The expected transition period for an optional form of benefit is the period that begins when the amendment is adopted and ends when it is reasonable to expect, with respect to a section 411(d)(6)(B) protected benefit (*i.e.,* not taking into account future service), that the form being eliminated would be subsumed by another optional form of benefit (after taking into account expected future accruals). For this purpose, the expected transition period must be determined in accordance with reasonable actuarial assumptions about the future that are likely to result in the longest period of time until the eliminated optional form of benefit would be subsumed, such as the assumption that the participant's compensation will not increase and that future accruals will not exceed accruals in recent periods. In addition, if the plan is subsequently amended to reduce the rate of future benefit accrual (or otherwise to lengthen the expected transition period) before the end of the previously determined expected transition period, the later plan amendment must provide that the elimination of the optional form of benefit is void (or must provide for the effective date to be further extended to a new expected transition date that satisfies this paragraph

(e)(6) taking into account the subsequent amendment).

(iii) *Applicability of the delayed effective date rule limited to employees who continue to accrue benefits through the end of expected transition period*. An amendment eliminating an optional form of benefit under this paragraph (e)(6) must be limited to participants who continue to accrue benefits under the plan through the end of the expected transition period. Thus, for example, the plan amendment may not apply to any participant who has a severance from employment during the expected transition period.

(iv) *Special rule for section 204(h) notice*. See §54.4980F–1(b), Q&A–8(c), of this chapter for a special rule relating to this paragraph (e)(6).

(f) *Definitions and use of terms*—(1) *Ancillary benefit*. An *ancillary benefit* means a social security supplement (other than a QSUPP as defined in §1.401(a)(4)–12), a disability benefit not in excess of a qualified disability benefit described in section 411(a)(9), an ancillary life insurance or health insurance benefit, a death benefit under a defined contribution plan, a preretirement death benefit under a defined benefit plan, a plant shutdown benefit that does not continue past retirement age, or any other similar benefit that does not affect the payment of the accrued benefit. See §§1.401–1(b)(1)(i), (ii), and (iii) and 1.401(a)(4)–4(e)(2).

(2) *Applicable amendment date*. The term *applicable amendment date* means, with respect to a plan amendment, the later of the effective date of the amendment or the date the amendment is adopted.

(3) *Core options*—(i) *General rule*. The *core options* in a plan are—

(A) A straight life annuity under which the participant is entitled to a level life annuity with no benefit payable after the participant's death;

(B) A joint and contingent annuity under which the participant is entitled to a life annuity with a survivor annuity for the individual designated by the participant (whether or not the participant's spouse) that is 75% of the amount payable during the participant's life;

(C) A 10-year certain and life annuity under which the participant is entitled to a life annuity with a guarantee that payments will continue to any person designated by the participant for the remainder of a fixed period of 10 years if the participant dies before the end of the 10-year period; and

(D) The most valuable option for a participant with a short life expectancy (as defined in paragraph (f)(3)(iv) of this section).

(ii) *Treatment of similar core options with different actuarial factors and annuity starting dates*. Except for core options described in paragraph (f)(3)(i)(D) of this section, whether an option is a core option is determined without regard to the actuarial factors that are used to determine the amount of the distributions under those optional forms and without regard to annuity starting dates. Thus, two core options that are described in paragraph (f)(3)(i)(A) or (B) or (C) of this section are not different core options solely because the core options start on different annuity starting dates.

(iii) *Modification of core options to satisfy other requirements*. An annuity does not fail to be a joint and contingent annuity described in paragraph (f)(3)(i)(B) of this section or a 10-year certain and life annuity described in paragraph (f)(3)(i)(C) of this section as a result of differences to comply with applicable law, such as limitations on death benefits to comply with the incidental benefit requirement of §1.401–1(b)(1)(i) or on account of the spousal consent rules of section 417.

(iv) *The most valuable option for a participant with a short life expectancy* —(A) *General definition*. Except as provided in paragraph (f)(3)(iv)(B) of this section, *the most valuable option for a participant with a short life expectancy* means the optional form of benefit, for each annuity starting date, that is reasonably expected to result in payments that have the largest actuarial present value in the case of a participant who dies shortly after the annuity starting date, taking into account both payments due to the participant prior to the participant's death and any payments due after the participant's death. For this purpose, a plan is permitted to assume that the spouse of the participant is the same age as the participant. In addition, a plan is permitted to assume that the optional form of benefit that is the most valuable option for a participant with a short life expectancy when the participant is age 70½ also is the most valuable option for a participant with a short life expectancy at all older ages, and that the most valuable option for a participant with a short life expectancy at age 55 is the most valuable option for a participant with a short life expectancy at all younger ages.

(B) *Safe harbor hierarchy*—(*1*) A plan may treat a single-sum distribution option with an actuarial present value that is not less than the actuarial present value of any optional form of benefit eliminated by the plan amendment as the most valuable option for a participant with a short life expectancy for each annuity starting date if it is available at all annuity starting dates, without regard to whether the option was available before the plan amendment.

(*2*) If a plan before the amendment does not offer a single-sum distribution option as described in paragraph (f)(3)(iv)(B)(*1*) of this section, a plan may treat a joint and contingent annuity with a continuation percentage that is at least 75% and that is at least as great as the highest continuation percentage available before the amendment as the most valuable option for a participant with a short life expectancy for each annuity starting date if it is available at all annuity starting dates, without regard to whether the option was available before the plan amendment.

(*3*) If the plan before the amendment offers neither a single-sum distribution option as described in paragraph (f)(3)(iv)(B)(*1*) of this section nor a joint and contingent annuity with a continuation percentage as described in paragraph (f)(3)(iv)(B)(*2*) of this section, a plan may treat a term certain and life annuity with a term certain period no less than 15 years as the most valuable option for a participant with a short life expectancy for each annuity starting date if it is available at all annuity starting dates, without regard to whether the option was available before the plan amendment.

(4) *Definitions of types of section 411(d)(6)(B) protected benefits*—(i) *Early retirement benefit*. An *early retirement benefit* means the right, under the terms of a plan, to commence distribution of a retirement-type benefit at a particular date after severance from employment with the employer and before normal retirement age. Different early retirement benefits result from differences in terms relating to timing.

(ii) *Optional form of benefit*. An *optional form of benefit* means a distribution alternative (including the normal form of

benefit) that is available under the plan with respect to benefits described in section 411(d)(6)(A) or a distribution alternative with respect to a retirement-type benefit. Different optional forms of benefit exist if a distribution alternative is not payable on substantially the same terms as another distribution alternative. The relevant terms include all terms affecting the value of the optional form, such as the method of benefit calculation and the actuarial assumptions used to determine the amount distributed. Thus, for example, different optional forms of benefit may result from differences in terms relating to the payment schedule, timing, commencement, medium of distribution (*e.g.*, in cash or in kind), election rights, differences in eligibility requirements, or the portion of the benefit to which the distribution alternative applies. Differences in the normal retirement ages of employees or in the form in which the accrued benefit of employees is payable at normal retirement age under a plan are taken into account in determining whether a distribution alternative constitutes one or more optional forms of benefit.

(iii) *Retirement-type benefit*. A *retirement-type benefit* means the payment of a distribution alternative with respect to an accrued benefit or the payment of any other benefit that continues after retirement that is not an ancillary benefit (including a QSUPP as defined in §1.401(a)(4)–12).

(iv) *Retirement-type subsidy*. A *retirement-type subsidy* means the excess, if any, of the actuarial present value of a retirement-type benefit, over the actuarial present value of the accrued benefit commencing at normal retirement age or at actual commencement date, if later, with both such actuarial present values determined as of the date the retirement-type benefit commences. Examples of retirement-type subsidies include a subsidized early retirement benefit and a subsidized qualified joint and survivor annuity as described in §1.415–3(c)(2)(i).

(v) *Subsidized early retirement benefit or early retirement subsidy*. A *subsidized early retirement benefit* or an *early retirement subsidy* means the right, under the terms of a plan, to commence distribution of a retirement-type benefit at a particular date after severance from employment with the employer and before normal retirement age where the actuarial present value of the optional forms of benefit available to the participant under the plan at that annuity starting date exceeds the actuarial present value of the accrued benefit commencing at normal retirement age (with such actuarial present values determined as of the annuity starting date). Thus, an early retirement subsidy is an early retirement benefit that provides a retirement-type subsidy.

(5) *Eliminate; elimination; reduce; reduction*. The terms *eliminate* or *elimination* when used in connection with a section 411(d)(6)(B) protected benefit mean to eliminate or the elimination of an optional form of benefit or an early retirement benefit and to reduce or a reduction in a retirement-type subsidy. The terms *reduce* and *reduction* when used in connection with a retirement-type subsidy mean to reduce or a reduction in the amount of the subsidy. For purposes of this section, an *elimination* includes a *reduction* and a *reduction* includes an *elimination*.

(6) *Retirement*. In general, for purposes of this section, the date of *retirement* refers to the annuity starting date. Thus, the term preretirement refers to the time period before the annuity starting date.

(7) *Other rights and features*. The term *other right or feature* generally means any right or feature applicable to employees under a plan. Different rights or features exist if a right or feature is not available on substantially the same terms as another right or feature. For exceptions to the definition of other right or feature, see §1.401(a)(4)–4(e)(3)(ii).

(8) *Actuarial present value*. For purposes of this section, the term *actuarial present value* means actuarial present value (within the meaning of §1.401(a)(4)–12) determined using reasonable actuarial assumptions.

(9) *Refund of employee contributions feature*. A *refund of employee contributions features* means a feature with respect to an optional form of benefit that provides for employee contributions and interest thereon to be paid in a single sum at the annuity starting date with the remainder to be paid in another form beginning on that date.

(10) *Retroactive annuity starting date feature*. A *retroactive annuity starting date* feature means a feature with respect to an optional form of benefit under which the annuity starting date for the distribution occurs prior to the date the participant is furnished the notice described in section 417(a)(3).

(11) *Section 411(d)(6)(B) protected benefit*. The term *section 411(d)(6)(B) protected benefit* means the portion of an early retirement benefit, a retirement-type subsidy, or an optional form of benefit attributable to the service of a participant before the applicable amendment date.

(12) *Social security leveling feature*. A *social security leveling feature* means a feature with respect to an optional form of benefit which is designed to provide an approximately level amount annually when the participant's estimated old age benefits from Social Security are taken into account.

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

Example 1. (i) *Facts involving amendments to an early retirement subsidy*. Plan A provides an annual benefit of 2% of career average pay times years of service commencing at normal retirement age (age 65). Plan A is amended on November 1, 2004, effective as of January 1, 2005, to provide for an annual benefit of 1.3% of final pay times years of service, with final pay computed as the average of a participant's highest 3 consecutive years of compensation. Participant M is age 50, he has 16 years of service, his career average pay is $37,500, and the average of his highest 3 consecutive years of compensation is $67,308. Thus, M's accrued benefit as of the effective date of the amendment is increased from $12,000 per year at normal retirement age (2% times $37,500 times 16 years of service) to $14,000 per year at normal retirement age (1.3% times $67,308 times 16 years of service). (These facts are similar to the facts in *Example 1* in paragraph (a)(4) of this section.) Before the amendment, Plan A permitted a former employee to commence distribution of benefits as early as age 55 and, for a participant with at least 15 years of service, actuarially reduced the amount payable in the form of a straight life annuity commencing before normal retirement age by 3% per year from age 60 to age 65 and by 7% per year from age 55 through age 59. Thus, before the amendment, the amount of M's early retirement benefit that would be payable for commencement at age 55 was $6,000 per year ($12,000 per year minus 3% for 5 years and minus 7% for 5 more years). The amendment also alters the actuarial reduction factor so that, for a participant with at least 15 years of service, the amount payable in a straight life annuity commencing before normal retirement age is reduced by 6% per year. As a result, the amount of M's early retirement benefit at age 55 becomes $5,600 per year after the amendment ($14,000 minus 6% for 10 years).

(ii) *Conclusion*. The straight life annuity payable under Plan A at age 55 is an optional form of benefit that is an early retirement subsidy. The plan amendment fails to satisfy the requirements of section 411(d)(6)(B) because the amendment decreases

the optional form of benefit payable to Participant M below the level that Participant M was entitled to receive immediately before the effective date of the amendment. If instead Plan A had included a provision under which M's straight life annuity payable at any age could be not be less than what it was immediately before the amendment (so that M's straight life annuity payable at age 55 could not be less than $6,000 per year), then the amendment would not fail to satisfy the requirements of section 411(d)(6)(B) with respect to M's straight life annuity payable at age 55 (although the straight life annuity payable to M at age 55 would not increase until the point in time at which the new formula amount with the new actuarial reduction factors exceeds the amount payable under the minimum provision, approximately 14 months after the amendment becomes effective).

Example 2. (i) *Facts involving contingent-event benefits*. Plan B permits participants who have a severance from employment before normal retirement age to commence distributions at any time after age 55 with the amount payable to be actuarially reduced using reasonable actuarial assumptions regarding interest and mortality, but provides that the annual reduction for any participant who has at least 20 years of service and who has a severance from employment after age 55 is only 3% per year (which is a smaller reduction than would apply under reasonable actuarial reductions). Plan B also provides two plant shutdown benefits to participants who have a severance of employment as a result of a plant shutdown. First, the favorable 3% actuarial reduction will apply for commencement of benefits after age 55 and before age 65 for any participant who has a severance from employment as a result of a plant shutdown and who has at least 10 years of service. Second, all participants who have at least 20 years of service and who have a severance from employment after age 55 (and before retirement age) as a result of a plant shutdown will receive a supplement. Under the supplement, an additional amount equal to the participant's estimated old-age insurance benefit under the Social Security Act is payable until age 65. The supplement is not a QSUPP, as defined in §1.401(a)(4)–12, because the plan's terms do not state that the supplement is treated as an early retirement benefit that is protected under section 411(d)(6).

(ii) *Conclusion*. The benefit payable with the 3% annual reduction is a retirement-type benefit. The excess of the actuarial present value of the early retirement benefit using the 3% annual reduction over the actuarial present value of the normal retirement benefit is a retirement-type subsidy and the right to receive payments of the subsidy at age 55 is an early retirement benefit. Thus, the right to receive the retirement-type subsidy for participants with at least 10 years of service at the time of a plant shutdown is an early retirement benefit that provides a retirement-type subsidy and is a section 411(d)(6)(B) protected benefit (even though no plant shutdown has occurred). Therefore, a plan amendment cannot eliminate this benefit with respect to service before the applicable amendment date, even before the occurrence of the plant shutdown. Because the plan provides that the supplement cannot exceed the OASDI benefit (Social Security), the supplement is a social security supplement, which is an ancillary benefit that is not a section 411(d)(6)(B) protected benefit.

Example 3. (i) *Facts involving elimination of optional forms of benefit as redundant*. Plan C is a defined benefit plan under which employees may elect to commence distributions at any time after the later of termination of employment or attainment of age 55. At each potential annuity starting date, Plan C permits employees to select, with spousal consent where required, a straight life annuity or any of a number of actuarially equivalent alternative forms of payment, including a straight life annuity with cost-of-living increases and a joint and contingent annuity with the participant having the right to select any beneficiary and any continuation percentage from 1% to 100%, subject to modification to the extent necessary to satisfy the requirements of the incidental benefit requirement of §1.401–1(b)(1)(i). The amount of any alternative payment is determined as the actuarial equivalent of the straight life annuity payable at the same age using reasonable actuarial assumptions. On September 2, 2004, Plan C is amended to delete all continuation percentages for joint and contingent options other than 25%, 50%, 75% or 100%, effective with respect to annuity starting dates that are on or after January 1, 2005.

(ii) *Conclusion*. (A) *Categorization of family members under the redundancy rule*. The optional forms of benefit described in paragraph (i) of this *Example 3* are members of four families: a straight life annuity; a straight life annuity with cost-of-living increases; joint and contingent options with continuation percentages of less than 50%; and joint and contingent options with continuation percentages of 50% or more. The amendment does not affect either of the first two families, but affects the two families relating to joint and contingent options.

(B) *Conclusion for elimination of optional forms of benefit as redundant*. The amendment satisfies the requirements of paragraph (c) of this section. First, the eliminated optional forms of benefit are redundant with respect to the retained optional forms of benefit because each eliminated joint and contingent annuity option with a continuation percentage of less than 50% is redundant with respect to the 25% continuation option and each eliminated joint and contingent annuity option with a continuation percent of 50% or higher is redundant with respect to any one of the retained 50%, 75%, or 100% continuation options. In addition, to the extent that the optional form of benefit that is being eliminated does not include a social security leveling feature, return of employee contribution feature, or retroactive annuity starting date feature, the retained optional form of benefit does not include that feature. Second, the amendment is not effective with respect to annuity starting dates that are less than 90 days from the date of the amendment. Third, the plan amendment does not eliminate any available core options, including the most valuable option for a participant with a short life expectance, treating a joint and contingent annuity with a 100% continuation percentage as this optional form of benefit pursuant to paragraph (f)(3)(iv)(B)(*2*) of this section. Finally, the amendment need not satisfy the requirements of paragraph (e) of this section because the retained optional forms of benefit are available on the same annuity starting dates and have the same actuarial present value as the optional forms of benefit that are being eliminated.

Example 4. (i) *Facts involving elimination of optional forms of benefit as redundant if additional restrictions are imposed*. The facts are the same as *Example 3*, except that the plan amendment also restricts the class of beneficiaries that may be elected under the four retained joint and contingent annuities to the employee's spouse.

(ii) *Conclusion*. The amendment fails to satisfy the requirements of paragraph (c)(2)(i)(C) of this section because the retained joint and contingent annuities have materially greater restrictions on the beneficiary designation than did the eliminated joint and contingent annuities. Thus, the joint and contingent annuities being eliminated are not redundant with respect to the retained joint and contingent annuities. In addition, the amendment fails to satisfy the requirements of the core option rules in paragraph (d) of this section because the amendment fails to be limited to annuity starting dates that are at least 4 years after the date the amendment is adopted, the amendment fails to include the core option in paragraph (f)(3)(i)(B) of this section because the participant does not have the right to designate any beneficiary, and the amendment fails to include the core option described in paragraph (f)(3)(i)(C) of this section because the plan does not provide a 10-year certain and life annuity.

Example 5. (i) *Facts involving elimination of a social security leveling feature and a period certain annuity as redundant*. Plan D is a defined benefit plan under which participants may elect to commence distributions in the following actuarially equivalent forms, with spousal consent if applicable: a straight life annuity; a 50%, 75%, or 100% joint and contingent annuity; a 5-year, 10-year, or a 15-year period certain and life annuity; and an installment refund annuity (*i.e.*, an optional form of benefit that provides a period certain, the duration of which is based on the participant's age), with the participant having the right to select any beneficiary. In addition, each annuity offered under the plan, if payable to a participant who is less than age 65, is available both with and without a social security leveling feature. The social security leveling feature provides for an assumed commencement of social security benefits at any age selected by the participant between age 62 and 65. Plan D is amended on September 1, 2004, effective as of January 1, 2005, to eliminate the installment refund form of benefit and to restrict the social security leveling feature to an assumed social security commencement age of 65.

(ii) *Conclusion*. The amendment satisfies the requirements of paragraph (c) of this section. First, the installment refund annuity option is redundant with respect to the 15-year certain and life annuity (except for advanced ages where, because of shorter life expectancies, the installment refund annuity option is redundant with respect to the 5-year certain and life annuity and also redundant with respect to the 10-year certain and life annuity). Second, with respect to restricting the social security leveling feature to an assumed social security commencement age of 65, under paragraph (c)(3)(ii) of this section, straight life annuities with social security leveling features that have different social security commencement ages are treated as members of the same family as straight life annuities without social security leveling features. To the extent an optional form of benefit that is being eliminated includes a social security leveling feature, the retained optional form of benefit must also include that feature, but it is permitted to have a different assumed age for commencement of

social security benefits. Third, to the extent that the optional form of benefit that is being eliminated does not include a social security leveling feature, a return of employee contribution feature, or retroactive annuity starting date feature, the retained optional form of benefit must not include that feature. Fourth, the plan amendment does not eliminate any available core options, including the most valuable option for a participant with a short life expectance, treating a joint and contingent annuity with a 100% continuation percentage as this optional form of benefit pursuant to paragraph (f)(3)(iv)(B)(*2*) of this section. Fifth, the amendment is not effective with respect to annuity starting dates that are less than 90 days from the date the amendment is adopted. The amendment need not satisfy the requirements of paragraph (e) of this section because the retained optional forms of benefit are available on the same annuity starting dates and have the same actuarial present value as the optional forms of benefit that are being eliminated.

Example 6. (i) *Facts involving elimination of non-core options*. Employer N sponsors Plan E, a defined benefit plan that permits every participant to elect payment in the following actuarially equivalent optional forms of benefit (Plan E's uniformly available options), with spousal consent if applicable: a straight life annuity, a 50%, 75%, or 100% joint and contingent annuity with no restrictions on designation of beneficiaries, and a 5-, 10-, or 15-year period certain and life annuity. In addition, each can be elected in conjunction with a social security leveling feature, with the participant permitted to select a social security commencement age from age 62 to age 67. None of Plan E's uniformly available options include a single-sum distribution. The plan has been in existence for over 30 years, during which time Employer N has acquired a large number of other businesses, including merging over 20 defined benefit plans of acquired entities into Plan E. Many of the merged plans offered optional forms of benefit that were not among Plan E's uniformly available options, including some plans funded through insurance products, often offering all of the insurance annuities that the insurance carrier offers, and with some of the merged plans offering single-sum distributions. In particular, under the XYZ acquisition, the XYZ acquired plan offered a single-sum distribution option that was frozen at the time of the acquisition. On April 1, 2005, each single-sum distribution option applies to less than 25% of the XYZ acquired participants' accrued benefits. Employer N has generally, but not uniformly, followed the practice of limiting the optional forms of benefit for an acquired unit to an employee's service before the date of the merger, and has uniformly followed this practice with respect to each of the early retirement subsidies in the acquired unit's plan. As a result, as of April 1, 2005, Plan E includes a large number of optional forms of benefit which are not members of families identified in paragraph (c)(4) of this section, but there are no participants who are entitled to any early retirement subsidies because any subsidies have been subsumed by the actuarially reduced accrued benefit. Plan E is amended in April of 2005 to eliminate all of the optional forms of benefit that Plan E offers other than Plan E's uniformly available options, except that the amendment does not eliminate any single-sum distribution option except with respect to XYZ acquired participants and permits any commencement date that was permitted under Plan E before the amendment. Plan E also eliminates the single-sum distribution option for XYZ acquired participants. Further, each of Plan E's uniformly available options has an actuarial present value that is not less than the actuarial present value of any optional form of benefit offered before the amendment. The amendment is effective with respect to annuity starting dates that are on or after May 1, 2009.

(ii) *Conclusion*. The amendment satisfies the requirements of paragraph (d) of this section. First, Plan E, as amended, does not eliminate any single-sum distribution option as provided in paragraph (d)(2)(iii) of this section except for single-sum distribution options that apply to less than 25% of a plan participant's accrued benefit as of the date the option is eliminated (May 1, 2009). Second, Plan E, as amended, includes each of the core options as defined in paragraph (f)(3) of this section, including offering the most valuable option for a participant with a short life expectancy (treating the 100% joint and contingent annuity as this benefit, under paragraph (f)(3)(iv)(B)(*2*) of this section). The grandfathered single-sum distribution options are not the most valuable option for a participant with a short life expectancy because these distributions are not available with respect to a participant's entire accrued benefit. In addition, as required under paragraph (d)(2) of this section, to the extent an optional form of benefit that is being eliminated includes either a social security leveling feature or a refund of employee contributions feature, at least one of the core options is available with that feature and, to the extent that the optional form of benefit that is being eliminated does not include a social security leveling feature or a refund of employee contributions feature, each of the core options is available without that feature. Third, the amendment is not effective with respect to annuity starting dates that are less than 4 years after the date the amendment is adopted. Finally, the amendment need not satisfy the requirements of paragraph (e) of this section because the retained optional forms of benefit are available on the same annuity starting date and have the same actuarial present value as the optional forms of benefit that are being eliminated.

Example 7. (i) *Facts involving reductions in actuarial present value*. (A) Plan F is a defined benefit plan providing an accrued benefit of 1% of the average of a participant's highest 3 consecutive years' pay times years of service, payable as a straight life annuity beginning at age 65. Plan F permits employees to elect to commence reduced distributions at any time after the later of termination of employment or attainment of age 55. At each potential annuity starting date, Plan F permits employees to select, with spousal consent, either a straight life annuity, a joint and contingent annuity with the participant having the right to select any beneficiary and a continuation percent of 50%, 66 2/3%, 75%, or 100%, or a 10-year certain and life annuity with the participant having the right to select any beneficiary, subject to modification to the extent necessary to satisfy the requirements of the incidental benefit requirement of §1.401–1(b)(1)(i). The amount of any joint and contingent annuity and the 10-year certain and life annuity is determined as the actuarial equivalent of the straight life annuity payable at the same age using reasonable actuarial assumptions. The plan covers employees at four divisions, one of which, division X, was acquired on January 1, 1999. The plan provides for distributions before normal retirement age to be actuarially reduced, but, if a participant retires after attainment of age 55 and completion of 10 years of service, the applicable early retirement reduction factor is 3% per year for the years between age 65 and 62 and 6% per year for the ages from 62 to 55 for all employees at any division, except for employees who were in division X on January 1, 1999, for whom the early retirement reduction factor for retirement after age 55 and 10 years of service is 5% for each year before age 65. On December 2, 2004, effective January 1, 2005, Plan F is amended to change the early retirement reduction factors for all employees of division X to be the same as for other employees, effective with respect to annuity starting dates that are on or after January 1, 2006, but only with respect to participants who are employees on or after January 1, 2006, and only if Plan F continues accruals at the current rate through January 1, 2006 (or the effective date of the change in reduction factors is delayed to reflect the change in the accrual rate). For purposes of this *Example 7*, it is assumed that an actuarially equivalent early retirement factor would have a reduction shown in column 4 of the following table, which compares the reduction factors for division X before and after the amendment:

1	2	3	4	5
Age	Old Division X Factor	New Factor	Actuarially Equivalent Factor	Column 3 minus Column 2
65	NA	NA	NA	NA
64	95	97	91.1	+2
63	90	94	83.2	+4
62	85	91	76.1	+5
61	80	85	69.8	+5

1	2	3	4	5
Age	Old Division X Factor	New Factor	Actuarially Equivalent Factor	Column 3 minus Column 2
60	75	79	64.1	+4
59	70	73	59.0	+3
58	65	67	54.3	+2
57	60	61	50.1	+1
56	55	55	46.3	0
55	50	49	42.8	-1

(B) On January 1, 2005, the employee with the largest number of years of service is Employee E, who is age 54 and has 20 years of service. For 2004, Employee E's compensation is $80,000 and E's highest 3 consecutive years of pay on January 1, 2005, is $75,000. Employee E's accrued benefit as of the effective date of the amendment is a life annuity of $15,000 per year at normal retirement age (1% times $75,000 times 20 years of service) and E's early retirement benefit commencing at age 55 has a present value of $91,397 as of January 1, 2005. It is assumed for purposes of this example that the longest expected transition period for any active employee does not exceed 5 months (20 years and 5 months, times 1% times 49% exceeds 20 years times 1% times 50%). Finally, it is assumed for purposes of this example that the amendment reduces optional forms of benefit which are burdensome or complex.

(ii) *Conclusion concerning application of section 411(d)(6)(B)*. The amendment reducing the early retirement factors has the effect of eliminating the existing optional forms of benefit (where the amount of the benefit is based on preamendment early retirement factors in any case where the new factors result in a smaller amount payable) and adding new optional forms of benefit (where the amount of benefit is based on the different early retirement factors). Accordingly, the elimination must satisfy the requirements of paragraph (c) or (d) of this section if the amount payable at any date is less than would have been payable under the plan before the amendment.

(iii) *Conclusion concerning application of redundancy rules*. The amendment satisfies the requirements of paragraph (c)(1)(i) and (ii) of this section (see paragraphs (iv) through (vi) of this *Example 7* for the requirements of paragraph (c)(1)(iii) of this section). First, with respect to each eliminated optional form of benefit (*i.e.*, with respect to each optional form of benefit with the Old Division X Factor), after the amendment there is a retained optional form of benefit that is in the same family of optional forms of benefit (*i.e.*, the optional form of benefit with the New Factor). Second, the amendment is not effective with respect to annuity starting dates that are less than 90 days from the date the amendment is adopted. Third, to the extent that the plan amendment eliminates the most valuable option for a participant with a short life expectancy, the retained optional form of benefit is identical except for differences in actuarial factors.

(iv) *Conclusion concerning application of the requirements under paragraph (e) of this section*. The plan amendment must satisfy the requirements of paragraph (e) of this section because, as of the applicable amendment date, the actuarial present value of the early retirement subsidy is less than the actuarial present value of the early retirement subsidy being eliminated. The plan amendment satisfies the requirements under paragraph (e)(1)(i) of this section because the amendment eliminates optional forms of benefit that create significant burdens or complexities for the plan and its participants. See below for the *de minimis* requirement under paragraph (e)(1)(ii) of this section.

(v) *Conclusion concerning application of de minimis rules under paragraph (e)(5) of this section*. The amendment does not satisfy the requirements of paragraph (e)(5) of this section because the reduction in the actuarial present value is more than a *de minimis* amount under paragraph (e)(5) of this section. For example, for Employee E, the amount of the joint and contingent annuity payable at age 55 is reduced from $7,500 (50% of $15,000) to $7,350 (49% of $15,000) and the reduction in present value as a result of the amendment is $1,828 ($91,397 - $89,569). In this case, the retirement-type subsidy at age 55 is the excess of the present value of the 50% early retirement benefit over the present value of the deferred payment of the accrued benefit, or $13,921 ($97,269 - $83,348) and the present value at age 54 of the retirement-type subsidy is $13,081. The reduction in present value is more than the greater of 2% of the present value of the retirement-type subsidy and 1% of E's compensation because the reduction in present value exceeds $800 (the greater of $262, which is 2% of the present value of the retirement-type subsidy for the benefit being eliminated, and $800, which is 1% of E's compensation of $80,000).

(vi) *Conclusion involving application of de minimis rules under paragraph (e)(6) relating to expected transition period*. The amendment satisfies the requirements of paragraph (e)(6) of this section and, thus, satisfies the requirements of paragraph (c) of this section, including the requirement in paragraph (c)(1)(iii) of this section that paragraph (e) of this section be satisfied. First, it is presumed that the amendment reduces optional forms of benefit that are burdensome or complex. Second, the plan amendment is not effective for annuity starting dates before January 1, 2006, and that date is not earlier than the longest expected transition period for any participant in Plan F on the date of the amendment. Third, the amendment does not apply to any participant who has a severance from employment during the transition period. If, however, a later plan amendment reduces accruals under Plan F, the initial amendment will no longer satisfy the requirements of paragraph (e)(6) of this section (and must be voided) unless, as part of the later amendment, the expected transition period is extended to reflect the reduction in accruals under Plan F.

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

PART 54—PENSION EXCISE TAXES

Par. 3. The authority citation for part 54 continues to read, in part, as follows:

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

§54.4980F–1 also issued under 26 U.S.C. 4980F.* * *

Par. 4. Section 54.4980F–1(b) is amended by:

1. Revising paragraph (c) of A–8.
2. Revising paragraph (d) of A–8.

The revisions read as follows:

§54.4980F–1 Notice requirements for certain pension plan amendments significantly reducing the rate of future benefit accrual.

* * * * *

A–8. * * *

(c) *Application to certain amendments reducing early retirement benefits or retirement-type subsidies*. Section 204(h) notice is not required for an amendment that reduces an early retirement benefit or retirement-type subsidy if the amendment is permitted under the third sentence of section 411(d)(6)(B) of the Internal Revenue Code and regulations thereunder (relating to the elimination or reduction of benefits or subsidies which create significant burdens or complexities for the plan and plan participants unless the amendment adversely affects the rights of any participant in a more than *de minimis* manner). However, in determining whether an amendment provides for a significant reduction for purposes of this section with respect to an amendment that has

an effective date on or after these rules are adopted as final regulations and that reduces a retirement-type subsidy as permitted under §1.411(d)–3(e)(6) of this chapter, the amendment is treated in the same manner as an amendment that limits the retirement-type subsidy to benefits that accrue before the applicable amendment date (as defined at §1.411(d)–3(f)(2) of this chapter) with respect to each participant or alternate payee to whom the reduction is reasonably expected to apply.

(d) *Example*. The following examples illustrate the rules in this Q&A–8:

Example 1. (i) *Facts*. Pension Plan A is a defined benefit plan that provides a rate of benefit accrual of 1% of highest-five years' pay multiplied by years of service, payable annually for life commencing at normal retirement age (or at actual retirement age, if later). Plan A is amended on August 1, 2007, effective January 1, 2008, to provide that any participant who separates from service after December 31, 2007, and before January 1, 2013, will have the same number of years of service he or she would have had if his or her service continued to December 31, 2012.

(ii) *Conclusion*. While the amendment will result in a reduction in the annual rate of future benefit accrual from 2009 through 2012 (because under the amendment, benefits based upon an additional five years of service accrue on January 1, 2008, and no additional service is credited after January 1, 2008, until January 1, 2013), the amendment does not result in a reduction that is significant because the amount of the annual benefit commencing at normal retirement age (or at actual retirement age, if later) under the terms of the plan as amended is not under any conditions less than the amount of the annual benefit commencing at normal retirement age (or at actual retirement age, if later) to which any participant would have been entitled under the terms of the plan had the amendment not been made.

Example 2. (i) *Facts*. The facts are the same as in *Example 1*, except that the 2008 amendment does not alter the plan provisions relating to a participant's number of years of service, but instead amends the plan's provisions relating to early retirement benefits. Before the amendment, the plan provides for distributions before normal retirement age to be actuarially reduced, but, if a participant retires after attainment of age 55 and completion of 10 years of service, the applicable early retirement reduction factor is 3% per year for the years between age 65 and 62 and 6% per year for the ages from 62 to 55. The amendment changes these provisions so that an actuarial reduction applies in all cases, but, in accordance with section 411(d)(6)(B), provides that no participant's early retirement benefit will be less than the amount provided under the plan as in effect on December 31, 2007, with respect to service before January 1, 2008. For participant X, the reduction is significant.

(ii) *Conclusion*. The amendment will result in a reduction in a retirement-type subsidy provided under Plan A (*i.e.*, Plan A's early retirement subsidy). Section 204(h) notice must be provided to participant X and any other participant for whom the reduction is significant and the notice must be provided at least 45 days before January 1, 2008 (or by such other date as may apply under Q&A–9 of this section).

Example 3. (i) *Facts*. The facts are the same as in *Example 2*, except that, for participant X, the change does not go into effect for any annuity starting date before January 1, 2009. Participant X continues employment through January 1, 2009.

(ii) *Conclusion*. The conclusion is the same as in *Example 2*. Taking into account the rule in the second sentence of Q&A–8(c) of this section, the reduction that occurs for participant X on January 1, 2009, is treated as the same reduction that occurs under *Example 2*. Accordingly, section 204(h) notice must be provided to participant X at least 45 days before January 1, 2008 (or by such other date as may apply under Q&A–9 of this section).

* * * * *

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on March 23, 2004, 8:45 a.m., and published in the issue of the Federal Register for March 24, 2004, 69 F.R. 13769)

Foundations Status of Certain Organizations

Announcement 2004–28

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

10th Cavalry Buffalo Soldiers Association, Inc., Atlanta, GA
312 Coldun Institute, Incorporated, Louisville, KY
A-Z Women Center, Inc., Maitland, FL
AAR Counseling Services, Inc., Naples, FL
Above and Beyond, Inc., Nashville, TN
Academy of Youth Athletics, Inc., Augusta, GA
Acting Out Theatre Company, Incorporated, Atlanta, GA
Actors Repertory Theatre of Naples, Inc., Naples, FL
Affordable America Housing, Inc., Palm Harbor, FL
Affordable Housing Organization of Florida, Inc., Winter Haven, FL
Against the Flow Ministries, Inc., Nashville, TN
Agape Restoration Center, College Park, GA
Albemarle Gymnastics Booster Club, Elizabeth City, NC
All About U Employment Services, Inc., Tallahassee, FL
Always Believe Foundation, Greensboro, NC
Amerihome, Inc., Atlanta, GA
Andy Smithey Foundation-Diabetes Research & Awareness, Inc., Alpharetta, GA
Animals Animals Animals, Inc., Palm Bay, FL
Anointed Hands Early Learning Center, Inc., Decatur, GA
Appalachian Standown, Huntington, WV
Appalachian Wilderness Experience, Asheville, NC
Apple Classic Scholarship Fund, Walhalla, SC
Archbishop B A Idahosa Foundation, Temple Hills, MD
Archway Regional Tourism Association, Zachariah, KY
Ark Foundation, Henderson, NC
Ark of Jackson County, Inc., Jefferson, GA
Arkadelphia Housing Group, Arkadelphia, AR
Asian Pacific Alliance Educational Foundation, Inc., Columbus, GA
Association for Women Attorneys Foundation, Memphis, TN
Association of Gospel Songwriters, Atlanta, GA
Athletics International, Inc., Marietta, GA
Atlanta 2000, Atlanta, GA
Atlanta Wild Animal Rescue Effort, Inc., Decatur, GA
Atlanta Youth Classical Theatre Company, Clarkston, GA
Augusta Georgia Sports and Achievement Hall of Fame, Inc., Augusta, GA
Babies of Georgia Fund, Inc., Marietta, GA

Barnes Golden-Age Haven, Inc., Columbus, GA
Barton Housing, Inc., Dunn, NC
Basic Beginnings, Inc., Decatur, GA
Beauchamp Tower Information Systems Corp., Milton, FL
Bethany Manor, Elizabeth City, NC
Bethany Missions, Inc., Atlanta, GA
Bethursday Business Park, Inc., Atlanta, GA
Big Hammock Archaeological Foundation, Inc., Sarasota, FL
Birchwood Learning Center, Inc., Durham, NC
Birdawg Ministries, Thompsons Stn, TN
Birmingham African-American Arts and Heritage, Inc., Birmingham, AL
Bishop Spalding Council No 2761 Knights of Columbus Charities, Inc., Louisville, KY
Black Belt World College Scholarship, Raleigh, NC
Bluegrass Community Marriage Task Force, Lexington, KY
Bold Maids Productions, Durham, NC
Bookworm Learning Center, Walnut Cove, NC
Bosnian Community, Inc., Louisville, KY
Boys & Girls Club of Pleasants County, Inc., St. Marys, WV
Boys & Girls Club of Thomson, Inc., Thomson, GA
Bradford Booster Club, Bradford, TN
Brandlewood Neighborhood Association, Inc., Savannah, GA
Break the Cycle, Inc., Loudon, TN
Breathitt County Community Council, Inc., Jackson, KY
Brentwood Blaze, Inc., Brentwood, TN
Brian Bloodworth Stroke & Head Injury Research Foundation, Inc., Whitehouse, TN
Bridge Health Foundation, Inc., Nashville, TN
Bright Hope, Inc., Ringgold, GA
Brother and Sisters Help End Straits, Lithonia, GA
Brown Magnolia CDC, Marianna, AR
Bukharian Jewish Community of Atlanta, Inc., Marietta, GA
Cameron Community Club, Inc., Cameron, SC
Cannon Baptist Child Development, Spartanburg, SC
Canopy Oaks Parent Teacher Organization P T O, Tallahassee, FL
Care for Caregivers, Inc., Roswell, GA
Caring Hearts Organization, Seminole, FL
Carolina Cardinals, Charlotte, NC
Carolina Sailing Center, Hilton Head, SC
Carolinas Heritage Tourism Network, Incorporated, Wilmington, NC
Catoma Volunteer Fire Protection Authority, Inc., Montgomery, AL
CCSCN, Inc., Greenville, NC
Center for Democratic Initiatives, Inc., Tijeras, NM
Center for Orthotic and Prosthetic Rehabilitation Institute, Inc., Louisville, KY
Central Atlanta Neighbor, Inc., Atlanta, GA
Centurion Outreach, Inc., Jackson, TN
Changed by Choice Ministries, Inc., Orlando, FL
Chapman Learning Center, Inc., New Corp., Knoxville, TN
Charleston Interactive Museum, Charleston, SC
Charlotte Fire Girls Basketball Club, Charlotte, NC
Charlotte Research Center, Charlotte, NC
Charter School Resource Center of Tennessee, Nashville, TN
Chattahoochee Foundation, Marietta, GA
Cherokee Indians of Georgia, Inc., Albany, GA
Children Aid Society of Atlanta, Inc., Atlanta, GA
Children-R-Special, Inc., Clarksville, TN
Chipola Boys and Girls Club, Marianna, FL
Choices-Turning Point, Inc., Palm Bay, FL
Christ is the Answer Ministries, Inc., Greenwood, SC
Christ the Rock Ministries, Inc., Kodak, TN
Christian Attic, Inc., Raleigh, NC
Christian Child Care Center, Inc., Memphis, TN
Christian Education Foundation, Inc., Dade City, FL
Christian Golfers Association of Middle Tennessee, Laverne, TN
Christian Radio Media, Inc., Homosasa, FL
Christians for Community Awareness, Inc., Durham, NC
City of Orangeburg Community Development Corporation, Orangeburg, SC
Clarence Rose Foundation, Goldsboro, NC
Clarion Call, Inc., Gastonia, NC
Classical Music Association Charlotte, Charlotte, NC
Clay County Consolidated Childrens Charities, Inc., Orange Park, FL
Clericare, Memphis, TN
Cleveland Community Playground Committee, Cleveland, TN
Coalition to Abolish the Fur Trade, Dallas, TX
Coatopa Belmont Volunteer Fire Department, Inc., Coatopa, AL
Columbians Housing Project, Inc., Lexington, KY
Communities for Kids, Belmont, MS
Communities Undertaking Technological Empowerment, Inc., Stone Mountain, GA
Community and Children in Crisis, Inc., Norcross, GA
Community and Economic Development Center, Inc., Manning, SC
Community Benefit Network, Inc., St. Petersburg, FL
Community Care Center of Brandon, Inc., Valrico, FL
Community Empowerment Project, Orlando, FL
Community Helps of Coosa County, Inc., Goodwater, AL
Community Light, Altamonte Springs, FL
Community Policing Interaction Association, Inc., Apopka, FL
Community Recreation & Sports, Inc., Ashland, KY
Community Urban Design Center, Raleigh, NC
Compassion Ministries of Indian Trail, Inc., Indian Trail, NC
Concerned Citizens of Clarksville, Clarksville, TN
Concert America Foundation, Inc., Raleigh, NC
Coney Island Sports Foundation, Inc., Brooklyn, NY
Courtwatch of Hillsborough County, Inc., Tampa, FL
Creative Community Services, Inc., Charlotte, NC
Crohns Disease Research, Inc., Winter Park, FL
Cultural Arts of Spencer County, Inc., Dale, IN
Daedalus Group, Inc., St. Petersburg, FL
Daily Devotion, Inc., Charlotte, NC
Dakota Youth Project, St. Petersburg, FL
D A L E Fund, Inc., Stone Mountain, GA
Dan Land and Derrick Moore Pro Football Camp, Albany, GA
Dance to a Different Drum, Inc., Atlanta, GA

Dances of Youth Dance Arts Nurturing the Creative Essence, Greensboro, NC
Dawn Foundation, Inc., Port Orange, FL
Daybreak Consultants Service, Inc., Atlanta, GA
DB Baseball, Inc., Daytona Beach, FL
Dearing Foundation, Inc., Macon, GA
Devi, Moundsville, WV
Diamond Association, Inc., Marietta, GA
Disabilities & Religion Project of Florida, Inc., Lakeland, FL
DLC Foundation, Inc., Austell, GA
Dream Builders Foundation, Inc., Atlanta, GA
Dream Catchers Therapeutic Riding Center, Inc., Conway, SC
DWC Foundation, Inc., Augusta, GA
Eagles Wings Outreach, Inc., Tallahassee, FL
Early Childhood Development Institute, Inc., Tucker, GA
Easley High School Loyalty Association, Inc., Easley, SC
East Carolina Community Services, Inc., Greenville, NC
East Tennessee Pride Basketball Association, Bristol, TN
Eco Access, Durham, NC
Ecuadorian League of Florida, Inc., Miami, FL
Educational Communication, Incorporated, Memphis, TN
Educational Solutions, Inc., Jacksonville, FL
Ellis Cross-Country Fire Department, Inc., Salisbury, NC
Emma Louise Eagan Scholarship Fund, Smyrna, GA
Employment Opportunity, Valdosta, GA
En Casa, Inc., Macon, GA
Ethiopian Community Association in Memphis, Memphis, TN
Exchange Club Center for the Prevention of Child Abuse, Inc., Tallahassee, FL
Ezras Team Enterprise, Inc., Stone Mountain, GA
Fairview Town Crier, Fairview, NC
Families & Youth for Christ, Maynardville, TN
Family Alternatives, Kingstree, SC
Family Crisis and Intervention Center, Fayetteville, NC
Fandango Farms, Hickory, NC
Fayette Animal Association, Somerville, TN
Feed My Sheep Soup Kitchen, Inc., No. Augusta, SC
Fertility Foundation, Inc., Charlotte, NC
Fighting Aids for Kids Foundation, Mt. Juliet, TN
First Chance Variety House, Marietta, GA
First Church of God Lenoir Child Development & Learning, Lenoir, NC
Fit for Eternity Ministries, Escondido, CA
Florida Arts & Cultural Education, Inc., St. Petersburg, FL
Florida Cancer Society, Inc., St. Petersburg, FL
Florida Foundation for the Future, Melbourne, FL
Florida Voters League, Inc., Ocala, FL
Florida World Museum of Natural History, Incorporated, Clearwater, FL
Fort Hill Ice House, Inc., Louisville, KY
Foundation for Advancement of Children Through Technology, Inc., Atlanta, GA
Foundation for Sun Valley, Inc., Matthews, NC
Fourth Avenue Step Team, Inc., Tallahassee, FL
Freedom Farm Ministries, Inc., St. Augustine, FL
Friend in Need Foundation, Pembroke, NC
Friend to Friend of East Tennessee, Morristown, TN
Friends of International at Mobile, Inc., Mobile, AL
Friends of the Anna Porter Public Library, Gatlinburg, TN
Friends of the Veterans Affairs Medical Center Foundation, Inc., Birmingham, AL
Friendship & Resources for International Edification & Nurturing Zones, Inc., Columbus, GA
Frog Loggers, Inc., Lexington, KY
Full Net, Inc., Louisville, KY
Funset Social and Charity Club, Huntsville, AL
Gandhi Foundation of USA, Inc., Stone Mountain, GA
Gardner Foundation, Inc., Fort Mill, SC
Gateway Pet Rescue, Inc., Blue Ridge, GA
Gateway Towers Resident Council, Incorporated, Chattanooga, TN
Genesis Group of Lebanon, Lebanon, TN
Georgia Council on High School Dropout Prevention, Inc., Atlanta, GA
Georgia Evaluation and Satisfaction Team, Inc., Talking Rock, GA
Georgia Rocket Basketball, Inc., Snellville, GA
Giant Step Family Preservation Centers, Inc., St. Petersburg, FL
Gilbert Baker Ministries, Inc., Smithfield, NC
Gills Creek Watershed Association, Columbia, SC
Given in Love Adoption Agency, Inc., Mary Esther, FL
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Glorious Light Ministries, Inc., Dublin, GA
G O A L, Inc., Greensboro, NC
Good News 2000 & Beyond, Inc., Asheville, NC
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Grace By Day, Birmingham, AL
Grace Evangelistic Ministries, Inc., Nashville, TN
Great Commission Ministries, Incorporated, Dunn, NC
Greater Cause Ministries-Unlimited, Inc., Lyons, GA
Greenways for Oldham County, Inc., Crestwood, KY
Gregory Burchell Journalism Scholarship, Baton Rouge, LA
Guardian Association of Pinellas County, Inc., Pinellas Park, FL
Hancock County Health Coalition, Sparta, GA
Hands of Stone International Museum of Humanities and Arts, Inc., Ocala, FL
Happy Delivery, Mattews, NC
Hardee Foundation, Washington, NC
Hardin County Humane Society, Inc., Radcliff, KY
Harvest Ministries & Enterprises, Inc., Montgomery, AL
Harvest of Love, Inc., College Park, GA
Hazard City Schools Educational Endowment Foundation, Inc., Hazard, KY
Health Education and Community Resource, Inc., Jacksonville, FL
Hearth and Home Housing Corp., St. Petersburg, FL
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Heaven Sent Services, Maryville, TN
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Helping Hands Programs for Youth and Families, Inc., Sarasota, FL
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Homeownership Center, Charlotte, NC

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International Hmong & Lao Women Association, Valdese, NC
International Marine Educators, Inc., Stuart, FL
International Network to Freedom Association, Washington, DC
J C Ranch, Inc., Atlanta, GA
Jacksonville Pastors and Christian Leaders Fellowship, Inc., Jacksonville, FL
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If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D. —Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z —Corporation.

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