

Relief from the Anti-cutback Requirements of § 411(d)(6) for Certain ESOP Amendments

Notice 2013-17

I. Purpose

This notice provides relief from the anti-cutback requirements of § 411(d)(6) of the Internal Revenue Code for plan amendments that eliminate a distribution option described in § 401(a)(28)(B)(ii)(I) from an employee stock ownership plan, as defined in § 4975(e)(7) (ESOP), that becomes subject to the diversification requirements of § 401(a)(35), which apply to certain defined contribution plans that hold (or are treated as holding) publicly traded employer securities. This notice addresses circumstances in which an ESOP that satisfied the diversification requirements of § 401(a)(28)(B)(i) by allowing distribution of a portion of a participant's account has become subject to the diversification requirements of § 401(a)(35). As a result of becoming subject to § 401(a)(35)(E), § 401(a)(28)(B) no longer applies and such an ESOP is no longer able to make distributions that (in the absence of the applicability of § 401(a)(28)(B)(i)) would be impermissible under other rules restricting the distribution of plan benefits before termination of employment or the occurrence of certain other events. Thus, under current rules for such plans, some in-service distribution options used to satisfy the diversification requirements under § 401(a)(28)(B) are no longer permissible.

The relief provided by this notice allows amendment of the ESOP to eliminate all in-service distribution options previously used to satisfy the diversification requirements of § 401(a)(28)(B)(i). The relief applies to amendments that are both adopted and put into effect under a plan by the last day of the first plan year beginning on or after January 1, 2013, or by the time the plan must be amended to satisfy § 401(a)(35), if later. In cases in which an ESOP has been timely amended to satisfy § 401(a)(35) and the remedial amendment period with respect to that amendment expires before the ending date of § 411(d)(6) relief, this notice also extends the remedial amendment period to the last day of the first plan year beginning on or after January 1, 2013, to permit the adoption of an amendment to the ESOP eliminating a distribution option described in § 401(a)(28)(B)(ii)(I).

II. Background

Section 401(a)(28)(B) requires an ESOP to satisfy certain requirements relating to diversification of investments. In general, under § 401(a)(28)(B)(i), an ESOP must provide certain participants the opportunity to elect to direct the plan as to the investment of at least 25 percent of the participant's account. The election must be available to a participant during the 90-day period following the close of each plan year in the 6-plan-year period beginning with the first plan year in which the participant has both attained age 55 and completed 10 years of participation. Section 401(a)(28)(B)(ii) allows an ESOP to satisfy the diversification requirements of § 401(a)(28)(B)(i) by, among other means, distributing the portion of a participant's account that is covered by the election within 90 days after the period during which the election may be made. Section 401(a)(28)(B)(v) provides that the diversification requirements of

§ 401(a)(28)(B) do not apply to an applicable defined contribution plan as defined in § 401(a)(35)(E). Thus, the diversification requirements of § 401(a)(28)(B) do not apply to a plan that is subject to § 401(a)(35).

Section 401(a)(35), which was added by section 901(a)(1) of the Pension Protection Act of 2006 (“PPA ’06”), Pub. L. 109-280, requires an applicable defined contribution plan within the meaning of § 401(a)(35)(E) to meet certain diversification requirements with respect to investments in employer securities. Unlike § 401(a)(28)(B), the § 401(a)(35) diversification requirements cannot be satisfied by distributing a portion of the participant’s account. The requirements of § 401(a)(35) generally apply to plan years that begin after December 31, 2006. Final regulations under § 401(a)(35) were published on May 19, 2010, 75 F.R. 27933. Under § 401(a)(35)(E) and § 1.401(a)(35)-1(f)(2)(ii) of the regulations, an ESOP that holds employer securities that are readily tradable on an established securities market is an “applicable defined contribution plan” that is subject to the requirements of § 401(a)(35) if either the ESOP is not a separate plan for purposes of § 414(l) but rather is a portion of a larger plan, or the ESOP holds contributions that are or were subject to § 401(k) or § 401(m).

An ESOP that is an applicable defined contribution plan ceases to be subject to the diversification requirements of § 401(a)(28)(B) (and must instead satisfy the diversification requirements of § 401(a)(35)) as of the effective date of § 401(a)(35). See § 401(a)(28)(B)(v).

Section 411(d)(6)(A) provides generally that a plan does not satisfy § 401(a) if an amendment to the plan decreases a participant’s accrued benefit. Section 411(d)(6)(B) provides that a plan amendment that has the effect of eliminating an optional form of benefit with respect to benefits attributable to service before the amendment is treated as reducing accrued benefits. Section 411(d)(6)(C) provides that an ESOP is not treated as failing to meet the requirements of § 411(d)(6) merely because it modifies distribution options in a nondiscriminatory manner.

Section 1.411(d)-4, A-2(d), describes certain exceptions from the general requirements of § 411(d)(6) with respect to ESOPs and stock bonus plans. Section 1.411(d)-4, A-2(d)(4), authorizes the Commissioner to prescribe additional rules and exceptions.

Notice 88-56, 1988-1 C.B. 540, provides guidance regarding the requirements of § 401(a)(28)(B). Q&A-14 of Notice 88-56 provides, in part, that a distribution in satisfaction of a diversification election under § 401(a)(28)(B) is not subject to the rules under § 401(a) restricting the distribution of plan benefits before termination of employment (in the case of a pension plan) or the occurrence of certain other events (in the case of a profit-sharing plan). Thus, an ESOP that includes a qualified cash or deferred arrangement, as defined in § 401(k)(2), may provide for and make a distribution, in satisfaction of a diversification election under § 401(a)(28)(B)(ii)(I), of amounts attributable to elective contributions, even if that distribution would otherwise be prohibited under § 401(k)(2)(B) and § 1.401(k)-1(d).

Section 1107 of PPA '06 provides that a plan amendment made pursuant to PPA '06 or regulations thereunder was not required to be adopted until a specified date (the "section 1107 date") that was the last day of the first plan year that begins on or after January 1, 2009 (or January 1, 2011, in the case of a governmental plan as defined in § 414(d)), provided that certain conditions were satisfied. Section 1107 of PPA '06 also provides that, except as provided by the Secretary, a plan does not fail to satisfy the anti-cutback requirements of § 411(d)(6) as a result of amendments made pursuant to PPA '06 or regulations thereunder that were adopted by the plan's section 1107 date, provided that the same conditions were satisfied. Generally, the conditions under section 1107 are satisfied if:

- (1) the plan amendment is made pursuant to a provision of PPA '06 or regulations thereunder;
- (2) the plan amendment is adopted no later than the plan's section 1107 date; and
- (3) the plan is operated as if the plan amendment were in effect during the period beginning on the effective date of the amendment and ending on the plan's section 1107 date or, if earlier, the date the amendment is adopted.

A plan is not treated as failing to be operated in accordance with its terms during the period described in (3), provided that the conditions in (1) through (3) are met.

Section 401(b) provides a period during which a plan may be amended retroactively to comply with the Code's qualification requirements. Section 1.401(b)-1 describes "disqualifying provisions" that may be amended retroactively and the remedial amendment period during which retroactive amendments may be adopted. Under § 1.401(b)-1(b)(3), the term "disqualifying provisions" includes a plan provision designated by the Commissioner as a disqualifying 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 of the Code that has been changed. Section 1.401(b)-1(f) gives the Commissioner the discretion to extend the remedial amendment period with respect to a disqualifying provision.

Rev. Proc. 2007-44, 2007-2 C.B. 54, provides guidance regarding the timing of plan amendments. Section 5.01 of Rev. Proc. 2007-44 designates as a disqualifying provision any plan provision that (1) results in the failure of the plan to satisfy the qualification requirements of the Code by reason of a change in those requirements that is effective after December 31, 2001, or (2) is integral to a qualification requirement of the Code that has been changed effective after December 31, 2001, but only if the provision is integral to a plan provision that is a disqualifying provision. Section 5.02 of Rev. Proc. 2007-44 clarifies that, for this purpose, a change in a qualification requirement includes a statutory change or a change in the requirements provided in regulations or other guidance published in the Internal Revenue Bulletin. In addition, for this purpose, a disqualifying provision includes the absence from the plan of a provision

required by or, if applicable, integral to the applicable change in the qualification requirements of the Code.

Section 5.05 of Rev. Proc. 2007-44 provides that, when there are statutory or regulatory changes to the plan qualification requirements that will affect provisions of the written plan document, the adoption of an interim amendment generally will be required by the later of the end of the plan year in which the change is first effective or the due date of the employer's tax return for the tax year that includes the date the change is first effective. Section 5.07(2) of Rev. Proc. 2007-44 provides an exception from the general deadline for adopting interim amendments. This section provides that the deadline for adopting an interim amendment pursuant to a provision of PPA '06 or regulations thereunder is a plan's section 1107 date. This date is also the deadline for adopting a discretionary amendment (within the meaning of section 5.05(2) of Rev. Proc. 2007-44) pursuant to a provision of PPA '06 or regulations thereunder.

Pursuant to section 6.02 of Rev. Proc. 2007-44, an interim amendment adopted timely and in good faith to correct a disqualifying provision as described in section 5.01 of Rev. Proc. 2007-44 can itself be a disqualifying provision as described in § 1.401(b)-2(b)(1). In this situation, a remedial amendment to correct this second disqualifying provision (that is, the interim amendment which was found to be itself a disqualifying provision) must be adopted by the end of the applicable 5- or 6-year remedial amendment cycle.

Notice 2009-97, 2009-52 I.R.B. 972, extends the deadline for adopting an interim or discretionary plan amendment pursuant to certain sections of the Code that were added or amended by PPA '06, including § 401(a)(35), to the last day of the first plan year that began on or after January 1, 2010. Continued satisfaction of the operational compliance requirements of section 1107 of PPA'06 was required as a condition of the extension of the deadline for adopting plan amendments. Section 401(b) does not relieve a plan of the requirement to satisfy § 411(d)(6) with respect to any amendment. Notice 2009-97 does not provide relief from the requirements of § 411(d)(6) for plan amendments adopted pursuant to § 401(a)(35) by the extended deadline but after a plan's section 1107 date.

In certain cases, the deadline to adopt an amendment to satisfy § 401(a)(35) is later than the last day of the first plan year that begins on or after January 1, 2010. For example, assume § 401(a)(35) is first effective with respect to a single employer calendar year ESOP on January 1, 2015, because the employer securities held by the ESOP first become readily tradable on an established securities market in the last quarter of 2014. In this case, the deadline to adopt an amendment to the plan to satisfy § 401(a)(35) is the later of December 31, 2015, or the due date of the employer's tax return for the tax year that includes January 1, 2015. The amendment must also satisfy the requirements of § 411(d)(6).

III. Relief from the Anti-cutback Requirements of § 411(d)(6)

In the case of an ESOP that satisfies the diversification requirements of § 401(a)(28)(B) by distributing a portion of the participant's account in accordance with

§ 401(a)(28)(B)(ii)(I) and that becomes subject to the requirements of § 401(a)(35), a plan amendment to eliminate the distribution option is adopted pursuant to a provision of PPA '06 if the amendment is effective no earlier than the effective date of § 401(a)(35) with respect to the plan. Thus, under section 1107 of PPA '06, such an amendment does not cause the plan to fail to satisfy the requirements of § 411(d)(6), provided that the amendment was adopted by the plan's section 1107 date and the other requirements of section 1107 of PPA '06 are met.

The relief from the requirements of § 411(d)(6) under section 1107 of PPA '06 does not apply to amendments adopted after a plan's section 1107 date, including amendments adopted pursuant to § 401(a)(35), regardless of when § 401(a)(35) is first effective with respect to the plan. The exceptions described in § 1.411(d)-4, A-2(d), also do not provide relief from the requirements of § 411(d)(6) for such amendments. Thus, without additional relief, a sponsor of an ESOP that is an applicable defined contribution plan might be prevented from amending the plan to eliminate a distribution option that was previously added to the plan to satisfy a requirement that no longer applies to the plan.

The Treasury Department and the Service recognize that additional relief from the requirements of § 411(d)(6) is appropriate. Accordingly, pursuant to § 1.411(d)-4, A-2(d)(4), an amendment to an ESOP that becomes subject to § 401(a)(35) to eliminate a distribution option previously provided to satisfy § 401(a)(28)(B)(i) does not cause the plan to fail to satisfy the requirements of § 411(d)(6) notwithstanding that the amendment is adopted after the plan's section 1107 date, but only if the amendment satisfies the conditions for relief under this notice. An amendment satisfies the conditions for relief under this notice if (i) the amendment is both adopted and put into effect under the plan by the last day of the first plan year beginning on or after January 1, 2013, or by the deadline for adopting an interim amendment to the plan to satisfy § 401(a)(35), if later, and (ii) the requirements of section 1107 of PPA '06 are met with respect to the amendment (other than the requirement that the amendment be adopted by the plan's section 1107 date). Such an amendment may, in certain cases (such as if the plan includes elective contributions under § 401(k)), be necessary to satisfy other qualification requirements.

IV. Extension of Deadline for Certain Amendments

An ESOP that satisfies the diversification requirements of § 401(a)(28)(B) by distributing a portion of the participant's account in accordance with § 401(a)(28)(B)(ii)(I) is not prevented from making the distribution by the rules under § 401(a) or § 401(k)(2)(B) and § 1.401(k)-1(d) that restrict the distribution of plan benefits. In contrast, an ESOP that becomes subject to § 401(a)(35), and that therefore ceases to be subject to § 401(a)(28)(B), must comply with the restrictions on distributions that apply before termination of employment (in the case of a pension plan), before the occurrence of certain other events (in the case of a profit-sharing or stock bonus plan), or before one of the events specified in § 401(k)(2)(B)(i) (in the case of amounts attributable to elective contributions and certain other amounts under a qualified cash or deferred arrangement). Thus, with respect to an ESOP that was subject to the requirements of § 401(a)(28)(B) and becomes an applicable defined contribution plan that is subject to

the requirements of § 401(a)(35), a provision of the plan that allows a distribution to be made before the termination of employment (in the case of a pension plan) or before one of the events specified in § 401(k)(2)(B)(i) (in the case of amounts attributable to elective contributions and certain other amounts under a qualified cash or deferred arrangement) is a disqualifying provision. Under § 401(b) and this notice, such a disqualifying provision will not cause a plan to be disqualified provided that a remedial amendment is adopted and put into effect under the plan within the remedial amendment period.

As provided in Rev. Proc. 2007-44 and Notice 2009-97, with respect to an ESOP subject to the requirements of § 401(a)(35), an interim amendment implementing those requirements was required to be adopted by the last day of the first plan year that began on or after January 1, 2010 (unless a later interim amendment deadline applies to the plan because § 401(a)(35) is first effective with respect to the plan after the PPA '06 effective date). This notice does not further extend the remedial amendment period for adopting such an interim amendment. However, for a plan that adopted such an interim amendment and that did not eliminate the distribution option described in § 401(a)(28)(B)(ii)(I), section 6.02 of Rev. Proc. 2007-44 provides that the remedial amendment period for the interim amendment extends until the end of the applicable 5- or 6-year remedial amendment cycle.

For example, assume the following facts. An ESOP that includes a qualified cash or deferred arrangement satisfies the diversification requirements of § 401(a)(28)(B) by distributing a portion of the participant's account attributable to elective contributions in accordance with § 401(a)(28)(B)(ii)(I). The ESOP's remedial amendment cycle is Cycle A. The ESOP becomes subject to § 401(a)(35) on January 1, 2007, and is timely amended to satisfy § 401(a)(35) by the last day of the first plan year beginning on or after January 1, 2010. The amendment to satisfy § 401(a)(35) does not eliminate the distribution option that was provided to satisfy § 401(a)(28)(B). Because the plan has ceased to be subject to § 401(a)(28)(B), however, the distribution option is prohibited by the rules under § 401(k)(2)(B) and § 1.401(k)-1(d) and results in a disqualifying provision. Under section 6.02 of Rev. Proc. 2007-44, the remedial amendment period for this disqualifying provision extends until the end of the applicable 5- or 6-year remedial amendment cycle. In this case, but for the further extension provided under the next paragraph of this notice, the remedial amendment period during which the ESOP must be amended to eliminate the prohibited distribution option would end on January 31, 2012, that is, the end of the plan's 5-year cycle (Cycle A) in which the remedial amendment period would otherwise expire.

If, as in the preceding example, the remedial amendment period with respect to the interim amendment that implements the requirements of § 401(a)(35) (i.e., the end of the plan's applicable 5- or 6-year remedial amendment cycle) expires prior to the ending date of the § 411(d)(6) relief granted by this notice for a plan amendment that eliminates the distribution option described in § 401(a)(28)(B)(ii)(I), this notice provides an extension of the remedial amendment period to enable a plan to adopt such an amendment for which § 411(d)(6) relief is granted. Accordingly, with respect to a subsequent plan amendment that eliminates the distribution option described in

§ 401(a)(28)(B)(ii)(I), the remedial amendment period provided under section 6.02 of Rev. Proc. 2007-44 is hereby extended until the last day of the first plan year beginning on or after January 1, 2013, if that remedial amendment period would otherwise expire at an earlier date. Thus, pursuant to this notice, with respect to an ESOP that is subject to § 401(a)(35), a plan provision that provides for a distribution option described in § 401(a)(28)(B)(ii)(I) will not cause the plan to be disqualified if a plan amendment eliminating the distribution option is both adopted and effective by the last day of the first plan year beginning on or after January 1, 2013 (or, if later, by the deadline for adopting an interim amendment to the plan to satisfy § 401(a)(35)).

If the remedial amendment period with respect to the interim amendment that implements the requirements of § 401(a)(35) expires after the ending date of the § 411(d)(6) relief granted by this notice for a plan amendment that eliminates the distribution option described in § 401(a)(28)(B)(ii)(I), the amendment must be both adopted and effective by the end of the period during which the § 411(d)(6) relief applies.

Drafting Information

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