Employee Plans CPE Technical Topics for 1999

OTHER PUBLISHED GUIDANCE

Coordinated by Al Reich

Employee Plans Division
National Office

Internal Revenue Service
Office of Assistant Commissioner (Employee Plans and Exempt Organizations)
CP:E

CONTENTS

T.D. 8806

Employee Stock Ownership Plans;Section 411(d)(6) Protected Benefits (Taxpayer Relief Act of 1997); Qualified Retirement Plan Benefits

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations providing for changes to the rules regarding qualified retirement plan benefits that are protected from reduction by plan amendment, that have been made necessary by the Taxpayer Relief Act of 1997 (TRA '97).

The final regulations change the existing final regulations to conform with the TRA '97 rules regarding in-kind distribution requirements for certain employee stock ownership plans, and specify the time period during which certain plan amendments for which relief has been granted by TRA '97 may be made without violating the prohibition against plan amendments that reduce accrued benefits. These final regulations affect sponsors of qualified retirement plans, employers that maintain qualified retirement

plans, and qualified retirement plan participants. The amendments to the temporary regulations remove previously issued temporary regulations on the same subject.

DATES: These regulations are effective January 8, 1999.

FOR FURTHER INFORMATION CONTACT: Linda S. F. Marshall, (202) 622-6030 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 411(d)(6). These regulations change the rules under section 411(d)(6) regarding qualified retirement plan benefits that are protected from reduction by plan amendment, to take into account amendments made by the Taxpayer Relief Act of 1997 (TRA '97), Public Law 105-34, 111 Stat. 788 (1997). On September 4, 1998, temporary regulations (TD 8781) under section 411(d)(6) were published in the Federal Register (63 FR 47172). A notice of proposed rulemaking (REG-101363-98), cross- referencing the temporary regulations, was published in the Federal Register (63 FR 47214) on the same day. The temporary regulations conform the regulations to the TRA '97 amendments to section 409 regarding the general requirement that employee stock ownership plans offer distributions in the form of employer securities. In addition, the temporary regulations specify the time period during which certain plan amendments for which relief has been granted by TRA '97 may be made without violating section 411(d)(6).

One written comment responding to the notice of proposed rulemaking was received. No public hearing was requested or held. The proposed regulations under section 411(d)(6) are adopted by this Treasury decision, and the corresponding temporary regulations are removed.

Explanation of Provisions

Section 411(d)(6) provides that a plan is not treated as satisfying the requirements of section 411 if the accrued benefit of a participant is decreased by a plan amendment. Under section 411(d)(6)(B), a plan amendment that eliminates an optional form of benefit is treated as reducing accrued benefits to the extent that the amendment applies to benefits accrued as of the later of the adoption date or the effective date of the amendment.

Sections 1.411(d)-4, Q&A-1(b)(1) and 1.401(a)(4)-4(e) specify that different optional forms of benefit within the meaning of section 411(d)(6)(B) result from differences in the medium of a distribution (e.g., cash or in-kind) from a plan. Section 411(d)(6)(C) provides that any tax credit employee stock ownership plan or any employee stock ownership plan is not treated as failing to meet the requirements of section 411(d)(6) merely because it modifies distribution options in a nondiscriminatory manner.

Special Rules Regarding Medium of Distribution from ESOPs

Section 409(h) contains requirements relating to distributions from tax credit employee stock ownership plans. Section 4975(e)(7) extends the requirements of section 409(h) to other employee stock ownership plans as well, and section 401(a)(23) extends the requirements of section 409(h) to qualified plans that are stock bonus plans.

Under section 409(h)(1)(A), an employee stock ownership plan or other stock bonus plan generally is required to make distributions available in the form of employer securities. Prior to its amendment by TRA '97, section 409(h)(2) provided an exception to this rule in the case of an employer whose charter or bylaws restrict the ownership of substantially all outstanding employer securities to employees or to a trust described in section 401(a).

Under section 1361, certain small business corporations that do not have more than 75 shareholders are eligible to elect treatment as S corporations whose tax attributes generally flow through to shareholders in accordance with the rules of subchapter S of chapter 1 of subtitle A of the Internal Revenue Code. Prior to the Small Business Job Protection Act of 1996 (SBJPA), Public Law 104- 188, 110 Stat. 1755 (1996), an S corporation could not maintain an employee stock ownership plan because an S corporation could not have a qualified trust described in section 401(a) as a shareholder. SBJPA amended the requirements for S corporations, effective for tax years beginning after December 31, 1996, to permit certain tax-exempt organizations, including qualified trusts described in section 401(a), to be S corporation shareholders.

TRA '97 made an additional change to the rules governing qualified plans holding securities of an S corporation employer, to make it easier for S corporation employers to facilitate employee ownership of employer securities through qualified plans. Section 1506 of TRA '97 extends the exception of section 409(h)(2) to cover S corporations, effective for taxable years beginning

after December 31, 1997. Pursuant to this change, tax credit employee stock ownership plans, employee stock ownership plans, and other stock bonus plans established and maintained by S corporation employers are not required to offer distributions in the form of employer securities.

Section 1.411(d)-4, Q&A-2(d)(2)(ii) provides an exception from the requirements of section 411(d)(6) for plan amendments that eliminate optional forms of benefit from a tax credit employee stock ownership plan, an employee stock ownership plan, or a stock bonus plan, for certain employers. Section 1.411(d)-4, Q&A-2(d)(2)(ii) applies to employers that become substantially employee-owned, if the employer otherwise meets the requirements of section 409(h)(2) with respect to restrictions on the ownership of outstanding employer stock. These regulations retain the provision in the temporary regulations to expand the exception of section 1.411(d)-4, Q&A- 2(d)(2)(ii) from the requirements of section 411(d)(6) to apply to S corporations as well, to reflect the TRA '97 changes to section 409(h).

Rules for Plan Amendments Pursuant to TRA '97

Section 1541 of TRA '97 contains provisions relating to plan amendments that are adopted as a result of TRA '97. If section 1541 applies to a plan amendment, section 1541(a) provides that the plan will be treated as operated in accordance with its terms and will not fail to satisfy the requirements of section 411(d)(6) by reason of the amendment. Section 1541 applies to a plan amendment that is made pursuant to a legislative change in the pension and employee benefit provisions of TRA '97, provided the following conditions are satisfied.

First, the plan amendment must be adopted before the first day of the first plan year beginning on or after January 1, 1999 (2001, in the case of a governmental plan, as defined in section 414(d)).

Second, the plan must be operated in accordance with the terms of the plan amendment, beginning on the date the legislative change takes effect, or, if the amendment is not required by the legislative change, the effective date of the amendment specified by the plan.

Third, the plan amendment must be made retroactively effective.

The remedial amendment period for adopting plan amendments to which section 1541 of TRA '97 applies was extended pursuant to the rules of section 401(b) in

Rev. Proc. 98-14 (1998-4 I.R.B. 22). To provide a uniform time for plan amendment, these regulations add a new section 1.411(d)-4, Q&A-11 to retain the rule of section 1.411(d)-4T, Q&A-11 of the temporary regulations extending the time for the section 411(d)(6) relief provided by section 1541 of TRA '97 to the end of the remedial amendment period for these plan amendments.

The sole commentator raised a concern regarding whether this extension of the time period for section 411(d)(6) relief originally provided under section 1541 of TRA '97 restricts the time during which any plan amendment can be made to eliminate in-kind distributions of employer securities from employee stock ownership plans of S corporations.

The extension of the time period for this section 1541 statutory relief pursuant to section 1.411(d)-4, Q&A-11 does not restrict the time period during which a plan amendment can be made to eliminate these in-kind distributions as permitted under section 1.411(d)-4, Q&A-2(d)(2)(ii); to the contrary, the section 1.411(d)-4, Q&A-11 extension of this statutory relief period provides an additional time period for the adoption of certain plan amendments to eliminate these in-kind distributions after these in-kind distributions have been eliminated in operation. Under the ongoing rule of section 1.411(d)-4, Q&A-2(d)(2)(ii), a plan amendment to eliminate these in-kind distributions that is effective with respect to distributions payable after the date the amendment is adopted can be made at any time during taxable years of the employer beginning after December 31, 1997.

Special Analyses

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

Drafting Information

The principal author of these regulations is Linda S. F. Marshall, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1 -- INCOME TAXES

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

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

Section 1.411(d)-4T also issued under 26 U.S.C. 411(d)(6). * * *

Par. 2. Section 1.411(d)-4 is amended by:

1. Revising Q&A-2(d)(2)(ii).

2. Removing the last sentence of Q&A-2(d)(3).

3. Adding Q&A-11.

The additions and revisions read as follows:

Section 1.411(d)-4 Section 411(d)(6) protected benefits.

* * * * *

Q-2: * * *

A-2: * * *

(d) * * *

(2) * * *

(ii) Employer becomes substantially employee-owned or is an S corporation. The employer eliminates, or retains the discretion to eliminate, with respect to all participants, optional forms of benefit by substituting cash distributions for distributions in the form of employer stock with respect to benefits subject to section 409(h) in the

circumstances described in paragraph (d)(1)(ii)(A) or (B) of this Q&A-2, but only if the employer otherwise meets the requirements of section 409(h)(2) --

(A) The employer becomes substantially employee-owned; or

(B) For taxable years of the employer beginning after December 31, 1997, the employer is an S corporation as defined in section 1361.

* * * * *

Q-11: To what extent may a plan amendment that is made pursuant to the Taxpayer Relief Act of 1997 (TRA '97) (Public Law 105-34, 111 Stat. 788), reduce or eliminate section 411(d)(6) protected benefits?

A-11: A plan amendment does not violate the requirements of section 411(d)(6) merely because the plan amendment reduces or eliminates section 411(d)(6) protected benefits as of the effective date of the plan amendment, provided that --

(a) The plan amendment is made pursuant to an amendment made by title XV, or subtitle H of title X, of TRA '97; and
(b) The plan amendment is adopted no later than the last day of any remedial amendment period that applies to the plan pursuant to sections 1.401(b)-1 and 1.401(b)-1T for changes under TRA '97.

Section 1.411(d)-4t [Removed]

Par. 3. Section 1.411(d)-4T is removed.

Robert E. Wenzel
Deputy Commissioner of Internal
Revenue Approved: * * *

Donald C. Lubick
Assistant Secretary of the
Treasury

Employee Plans CPE Technical Topics for 1999

Employee Plans CPE Technical Topics for 1999

REGULATIONS: Section 411(d)(6) Protected Benefits (Taxpayer Relief Act of 1997); Qualified Retirement Plan Benefits

[4830-01-u]
DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1
RIN 1545-AV95

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations providing for changes to the rules regarding qualified retirement plan benefits that are protected from reduction by plan amendment, that have been made necessary by the Taxpayer Relief Act of 1997 (TRA '97). The temporary regulations change the existing regulations to conform with the TRA '97 rules regarding in-kind distribution requirements for certain employee stock ownership plans, and specify the time period during which certain plan amendments for which relief has been granted by TRA '97 may be made without violating the prohibition against plan amendments that reduce accrued benefits. These temporary regulations affect sponsors of qualified retirement plans, employers that maintain qualified retirement plans, and qualified retirement plan participants. The final regulations amend the existing final regulations to cross-reference the temporary regulations. The text of the temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the Federal Register.

DATES: These regulations are effective September 4, 1998.

FOR FURTHER INFORMATION CONTACT: Linda S. F. Marshall, (202) 622-6030 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 411(d)(6). These temporary regulations change the rules under section 411(d)(6) regarding qualified retirement plan benefits that are protected from reduction by plan amendment, to take into account amendments made by the Taxpayer Relief Act of 1997 (TRA '97), Public Law 105-34 (111 Stat. 788 (1997)). Specifically, these temporary regulations change the existing regulations to conform to the TRA '97 amendments to section 409 regarding the general requirement that employee stock ownership plans offer distributions in the form of employer securities. In addition, these temporary regulations specify the time period during which certain plan amendments for which relief has been granted by TRA '97 may be made without violating section 411(d)(6).

Explanation of Provisions

Section 411(d)(6) provides that a plan is not treated as satisfying the requirements of section 411 if the accrued benefit of a participant is decreased by a plan amendment. Under section 411(d)(6)(B), a plan amendment that eliminates an optional form of benefit is treated as reducing accrued benefits to the extent that the amendment applies to benefits accrued as of the later of the adoption date or the effective date of the amendment. Sections 1.411(d)-4, Q&A-1(b)(1) and 1.401(a)(4)-4(e) specify that different optional forms of benefit within the meaning of section 411(d)(6)(B) result from differences in the medium of a distribution (e.g., cash or in-kind) from a plan. Section 411(d)(6)(C) provides that any tax credit employee stock ownership plan or any employee stock ownership plan is not treated as failing to meet the requirements of section 411(d)(6) merely because it modifies distribution options in a nondiscriminatory manner.

Special Rules Regarding Medium of Distribution from ESOPs

Section 409(h) contains requirements relating to distributions from tax credit employee stock ownership plans. Section 4975(e)(7) extends the requirements of section 409(h) to other employee stock ownership plans as well, and section 401(a)(23) extends the requirements of section 409(h) to qualified plans that are stock bonus plans. Under section 409(h)(1)(A), an employee stock ownership plan or other stock bonus plan generally is required to make distributions available in the form of employer securities. Prior to its amendment by TRA '97, section 409(h)(2) provided an exception to this rule in the case of an employer whose charter or bylaws restrict the ownership of

substantially all outstanding employer securities to employees or to a trust described in section 401(a).

Under section 1361, certain small business corporations that do not have more than 75 shareholders are eligible to elect treatment as S corporations whose tax attributes generally flow through to shareholders in accordance with the rules of subchapter S of chapter 1 of subtitle A of the Internal Revenue Code. Prior to the Small Business Job Protection Act of 1996 (SBJPA), Public Law 104-188 (110 Stat. 1755 (1996)), an S corporation could not maintain an employee stock ownership plan because an S corporation could not have a qualified trust described in section 401(a) as a shareholder. SBJPA amended the requirements for S corporations, effective for tax years beginning after December 31, 1996, to permit certain tax-exempt organizations, including qualified trusts described in section 401(a), to be S corporation shareholders.

TRA '97 made an additional change to the rules governing qualified plans holding securities of an S corporation employer, to make it easier for S corporation employers to facilitate employee ownership of employer securities through qualified plans. Section 1506 of TRA '97 extends the exception of section 409(h)(2) to cover S corporations, effective for taxable years beginning after December 31, 1997. Pursuant to this change, tax credit employee stock ownership plans, employee stock ownership plans, and other stock bonus plans established and maintained by S corporation employers are not required to offer distributions in the form of employer securities.

Section 1.411(d)-4, Q&A-2(d)(2)(ii) provides an exception from the requirements of section 411(d)(6) for plan amendments that eliminate optional forms of benefit from a tax credit employee stock ownership plan, an employee stock ownership plan, or a stock bonus plan, for certain employers. Section 1.411(d)-4, Q&A-2(d)(2)(ii) applies to employers that become substantially employee-owned, if the employer otherwise meets the requirements of section 409(h)(2) with respect to restrictions on the ownership of outstanding employer stock. These temporary regulations expand this exception from the requirements of section 411(d)(6) to apply to S corporations as well, to reflect the TRA '97 changes to section 409(h).

Rules for Plan Amendments Pursuant to TRA '97

Section 1541 of TRA '97 contains provisions relating to plan amendments that are adopted as a result of TRA '97. If section 1541 applies to a plan amendment, section 1541(a) provides that the plan will be treated as operated in accordance with its terms and will not fail to satisfy the requirements of section 411(d)(6) by reason of the amendment. Section 1541 applies to a plan amendment that is made pursuant to a legislative change in the pension and employee benefit provisions of TRA '97, provided the following conditions are satisfied. First, the plan amendment must be adopted before the first day of the first plan year beginning on or after January 1, 1999 (2001, in the case of a governmental plan, as defined in section 414(d)). Second, the plan must be operated in accordance with the terms of the plan amendment, beginning on the date the legislative change takes effect, or, if the amendment is not required by the legislative change, the effective date of the amendment specified by the plan. Third, the plan amendment must be made retroactively effective.

The remedial amendment period for adopting plan amendments to which section 1541 of TRA '97 applies was extended pursuant to the rules of section 401(b) in Rev. Proc. 98-14 (1998-4 I.R.B. 22). To provide a uniform time for plan amendment, these temporary regulations extend the time for the section 411(d)(6) relief provided by section 1541 of TRA '97 to the end of the remedial amendment period for these plan amendments.

Other Section 411(d)(6) Issues

In Notice 98-29 (1998-22 I.R.B. 8), the IRS requested public comment regarding a number of possible methods of providing section 411(d)(6) relief, particularly for defined contribution plans. The IRS will also consider comments submitted pursuant to Notice 98-29 that propose other methods of providing section 411(d)(6) relief to address special concerns of employee stock ownership plans.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for

Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Linda S. F. Marshall, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

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

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

Section 1.411(d)-4T also issued under 26 U.S.C. 411(d)(6). * * *

Par. 2. Section 1.411(d)-4 is amended by:

1. Removing the reference "Q&A-5" and adding Q&A-2" in its place in the first sentence of Q&A-2(d)(1) introductory text.

2. Adding a sentence at the end of Q&A-2(d)(3) to read as follows:

SECTION 1.411(d)-4 SECTION 411(d)(6) PROTECTED BENEFITS.
* * * * *

Q-2: * * *

A-2: * * *

(d) * * *

(3) * * * (For taxable years after December 31, 1997, see section 1.411(d)-4T Q&A-2(d).)

* * * * *

Par. 3. Section 1.411(d)-4T is added to read as follows:

SECTION 1.411(d)-4T SECTION 411(d)(6) PROTECTED BENEFITS

(TEMPORARY).

Q&A-1: [Reserved]. For further information, see section 1.411(d)-4 Q&A-1.

Q-2: To what extent may section 411(d)(6) protected benefits under a plan be reduced or eliminated?

(a) through (c) [Reserved]. For further information, see section 1.411(d)-4 Q&A-2(a) through (c).

(d) ESOP and stock bonus plan exception--(1) In general. Subject to the limitations in paragraph (d)(2) of this Q&A-2, a tax credit employee stock ownership plan (as defined in section 409(a)), an employee stock ownership plan (as defined in section 4975(e)(7)), or a stock bonus plan that is not an employee stock ownership plan will not be treated as violating the requirements of section 411(d)(6) merely because of the circumstances described in paragraph (d)(1)(ii) of this Q&A-2.

(i) [Reserved]. For further information, see section 1.411(d)-4 Q&A-2(d)(1)(i).

(ii) Employer becomes substantially employee-owned or is an S corporation. The employer eliminates, or retains the discretion to eliminate, with respect to all participants, optional forms of benefit by substituting cash distributions for distributions in the form of employer stock with respect to benefits subject to section 409(h) in the circumstances described in paragraph (d)(1)(ii)(A) or (B) of this Q&A-2, but only if the employer otherwise meets the requirements of section 409(h)(2)--

(A) The employer becomes substantially employee-owned; or

(B) For taxable years of the employer beginning after December 31, 1997, the employer is an S corporation as defined in section 1361.

(iii) and (iv) [Reserved]. For further information, see section 1.411(d)-4 Q&A-2(d)(1)(iii) and (iv).

(2) Limitations on ESOP and stock bonus plan exceptions. [Reserved]. For further information, see section 1.411(d)-4 Q&A- 2(d)(2).

(3) Effective date. Paragraph (d) of this Q&A-2 applies for taxable years beginning after December 31, 1997. For taxable years beginning prior to January 1, 1998, see section 1.411(d)-4 Q&A-2(d).

(4) [Reserved]. For further information, see section 1.411(d)-4 Q&A-2(d)(4).

Q&A-3 through Q&A-10 [Reserved]. For further information, see section 1.411(d)-4 Q&A-3 through Q&A-10.

Q-11: To what extent may a plan amendment that is made pursuant to the Taxpayer Relief Act of 1997 (TRA '97) (Public Law 105-34, 111 Stat. 788), reduce or eliminate section 411(d)(6) protected benefits?

A-11: A plan amendment does not violate the requirements of section 411(d)(6) merely because the plan amendment reduces or eliminates section 411(d)(6) protected benefits as of the effective date of the plan amendment, provided that--

(a) The plan amendment is made pursuant to an amendment made by title XV, or subtitle H of title X, of TRA '97; and

(b) The plan amendment is adopted no later than the last day of any remedial amendment period that applies to the plan pursuant to sections 1.401(b)-1 and 1.401(b)-1T for changes under TRA '97. Michael P. Dolan, Deputy Commissioner of Internal Revenue; Approved: July 24, 1998,Donald C. Lubick, Assistant Secretary of theTreasury

Rev. Proc. 99-13

26 CFR 601.202: Closing agreements.

1999-5 I.R.B. 52; REV. PROC. 99-13

Employee Plans CPE Technical Topics for 1999

February 1, 1999

SECTION 1. PURPOSE AND OVERVIEW

.01 Application of EPCRS to 403(b) Plans. This revenue procedure provides a comprehensive system of correction programs and procedures for an employer that offers a plan that is intended to satisfy the requirements of ' 403(b) of the Internal Revenue Code (the "Code"), but that has failed to satisfy those requirements because of Operational, Demographic, or Eligibility Failures. This system permits an employer to correct these failures, and thereby provide its employees with retirement benefits on a tax-favored basis. This revenue procedure modifies and amplifies the Employee Plans Compliance Resolution System (EPCRS), set forth in Rev. Proc. 98-22, 1998-12 I.R.B. 11, to include specific programs and procedures relating to 403(b) Plans. In addition, this revenue procedure replaces the program described in Rev. Proc. 95-24, 1995-1 C.B. 694, which established the Tax Sheltered Annuity Voluntary Correction (TVC) program, and which was extended by Rev. Proc. 96-50, 1996-2 C.B. 370. Except as otherwise indicated in this revenue procedure, the specific provisions of EPCRS apply to 403(b) Plans.

.02 Overview of EPCRS. Pursuant to Rev. Proc. 98-22, as modified by this revenue procedure, the following programs comprise EPCRS for correction of failures with respect to a 403(b) Plan.

(1) APRSC: Self-correction. The Administrative Policy Regarding Self-Correction (APRSC), as described in Rev. Proc. 98-22, is a voluntary employer-initiated program that does not involve Service approval. Under APRSC, an employer that has compliance practices and procedures may correct Operational Failures, without paying any fee or sanction, including Operational Failures relating to contributions to a 403(b) Plan that are in excess of the ' 415 limit or the ' 403(b)(2) limit (the exclusion allowance). APRSC is described in Section 7 of Rev. Proc. 98-22, as modified by sections 4 and 5 below.

(2) TVC: Voluntary correction with Service approval. Under TVC, an employer or plan that is not Under Examination (as defined in Section 5.06 of Rev. Proc. 98-22) may pay a limited fee and receive the Service's approval for the correction in the form of a closing agreement with the appropriate Key District Office. TVC allows correction of Operational Failures, Demographic Failures, and Eligibility Failures that are within the jurisdiction of the EP/EO Division of the Key District Office, including a Plan of an Ineligible Employer. TVC is described in sections 4, 6, 7, and 8 below.

(3) Audit CAP for 403(b) Plans: Correction on audit. Audit CAP as described in Rev. Proc. 98-22 is expanded by this revenue procedure to cover closing agreements in connection with a 403(b) Plan that is Under Examination. Under Audit CAP for 403(b) Plans, if an Operational Failure that is not eligible for APRSC, a Demographic Failure, or an Eligibility Failure is identified with respect to a 403(b) Plan that is Under Examination, and the failure is corrected, the sanction imposed will bear a reasonable relationship to the nature, extent, and severity of the failure. Audit CAP for 403(b) Plans is described in section 9 below (extending the program described in Sections 14 and 15 of Rev. Proc. 98-22).

.03 Request for comments. The Service specifically solicits comments or suggestions relating to the guidance provided in this revenue procedure. It is requested that comments or suggestions be submitted by May 2, 1999, addressed to CC:DOM:CORP:R (Rev. Proc. 99-13), Room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, comments may be hand-delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Rev. Proc. 99-13), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may transmit comments electronically via the Service's Internet site at "http://www.irs.ustreas.gov/prod/taxregs/comments.html".

SECTION 2. EFFECT OF EPCRS; RELIANCE

.01 Income taxes. If the applicable eligibility requirements are satisfied and the employer corrects a failure in accordance with the requirements of APRSC, TVC, or Audit CAP for 403(b) Plans, the Service will not pursue income inclusion for affected participants, or liability for income tax withholding, on account of the failure. However, the correction of a failure may itself result in income tax consequences to participants (for example, participants may be required to include in gross income distributions of Excess Amounts in the year of distribution).

.02 Excise and employment taxes. Excise taxes, FICA taxes, and FUTA taxes (and corresponding withholding obligations), if applicable, that result from a failure are not waived merely because the failure has been corrected.

.03 Other taxes and penalties. See Section 6.04 of Rev. Proc. 98-22 for rules relating to other taxes and penalties.

.04 Reliance. Taxpayers may rely on this revenue procedure, including the relief described in section 2.01.

SECTION 3. DEFINITIONS The following definitions apply for purposes of this revenue procedure.

.01 403(b) Plan. The term "403(b) Plan" means a plan or program intended to satisfy the requirements of ' 403(b), including a Plan of an Ineligible Employer.

.02 Demographic Failure. The term "Demographic Failure" means, with respect to a 403(b) Plan, a failure to satisfy the requirements of ' 401(a)(4), ' 401(a)(26), or ' 410(b) (as applied to 403(b) Plans pursuant to ' 403(b)(12)(A)(i)).

.03 Eligibility Failure. The term "Eligibility Failure" means, with respect to a 403(b) Plan, any of the following:

(1) A Plan of an Ineligible Employer;

(2) A failure to satisfy the nontransferability requirement of ' 401(g);

(3) A failure to initially establish or maintain a custodial account as required by ' 403(b)(7); or

(4) A failure to purchase (initially or subsequently) either an annuity contract from an insurance company (unless grandfathered under Rev. Rul. 82-102, 1982-1 C.B. 62) or a custodial account from a regulated investment company utilizing a bank or an approved non-bank trustee/custodian.

.04 Excess Amounts. The term "Excess Amounts" means any contributions or allocations to a 403(b) Plan that are in excess of the limits under ' 415 or ' 403(b)(2) (the exclusion allowance limit) for the year.

.05 Operational Failure. The term "Operational Failure" means, with respect to a 403(b) Plan, any of the following:

(1) A failure to satisfy the requirements in ' 403(b)(12)(A)(ii) (relating to the availability of salary reduction contributions);

(2) A failure to satisfy the requirements of ' 401(m) (as applied to 403(b) Plans pursuant to ' 403(b)(12)(A)(i));

(3) A failure to satisfy the requirements of ' 401(a)(17) (as applied to 403(b) Plans pursuant to ' 403(b)(12)(A)(i));

(4) A failure to satisfy the distribution restrictions of ' 403(b)(7) or ' 403(b)(11);

(5) A failure to satisfy the incidental death benefit rules of ' 403(b)(10);

(6) A failure to pay minimum required distributions under ' 403(b)(10);

(7) A failure to give employees the right to elect a direct rollover under ' 403(b)(10), including the failure to give meaningful notice of such right;

(8) A failure to satisfy the limit on elective deferrals under ' 403(b)(1)(E);

(9) A failure involving contributions or allocations of Excess Amounts; or

(10) Any other failure to satisfy applicable requirements under ' 403(b) that (a) results in the loss of ' 403(b) status for the plan or the loss of ' 403(b) status for the custodial account(s) or annuity contract(s) under the plan and (b) is not a Demographic Failure, an Eligibility Failure, or a failure related to the purchase of annuity contracts, or contributions to custodial accounts, on behalf of individuals who are not employees of the employer.

.06 Plan of an Ineligible Employer. The term "Plan of an Ineligible Employer" means a plan intended to satisfy the requirements of ' 403(b) but which is not eligible for favorable tax treatment under ' 403(b) because the employer is not a tax-exempt organization described in ' 501(c)(3) or a public educational organization described in ' 170(b)(1)(A)(ii).

.07 Total Sanction Amount. The term "Total Sanction Amount" means a monetary amount that is approximately equal to the income tax the Service could collect as a result of the failure.

SECTION 4. CORRECTION METHODS

.01 In general. The correction principles and rules of general applicability described in Section 6 of Rev. Proc. 98-22 apply to 403(b) Plans, except as provided in sections 4.02 and 4.03 below. Thus, a failure with respect to a 403(b) Plan is generally not corrected unless correction is made with respect to all participants and beneficiaries for all taxable years pursuant to this revenue procedure.

.02 Correction of Excess Amounts. Excess Amounts may be corrected only pursuant to paragraph (1) or (2) of this section 4.02.

(1) Distribution of Excess Amounts. In order to correct under this paragraph (1), Excess Amounts for a year, adjusted for earnings through the date of distribution, must be distributed to affected participants and beneficiaries and are includible in their gross income in the year distributed. A distribution of Excess Amounts is generally treated in the manner described in Section 3 of Rev. Proc. 92-93, 1992-2 C.B. 505, relating to the corrective disbursement of elective deferrals. The distribution must be reported on Forms 1099-R for the year of distribution with respect to each participant or beneficiary receiving such a distribution. The distribution of Excess Amounts is not an eligible rollover distribution within the meaning of ' 403(b)(8). In addition, the employer must inform affected participants and beneficiaries that the distribution of Excess Amounts is not eligible for rollover. Excess Amounts distributed pursuant to this paragraph (1) are not treated as amounts previously excludable under ' 403(b)(2)(A)(ii) for purposes of calculating the maximum exclusion allowance for the taxable year of the distribution and for subsequent taxable years.

(2) Retention of Excess Amounts. Alternatively, only under TVC and Audit CAP for 403(b) Plans, Excess Amounts will be treated as corrected (even though the Excess Amounts are retained in the 403(b) Plan) if the requirements of this paragraph (2) are satisfied. Excess Amounts arising from a ' 415 failure, adjusted for earnings through the date of correction, must reduce affected participants' applicable ' 415 limit for the year following the year of correction (or for the year of correction if the employer so chooses), and subsequent years, until the excess is eliminated. Excess Amounts (whether arising from a ' 415 failure or a ' 403(b)(2) failure), adjusted for earnings through the date of correction, must also reduce participants' exclusion allowances by being treated as amounts previously excludable under ' 403(b)(2)(A)(ii) beginning with the year following the year of correction (or the year of correction if the employer so chooses). The correction described in this paragraph (2) must generally be used for all participants who have Excess Amounts. See section 8.03 below for the correction compliance fee that is generally applicable to Excess Amounts corrected pursuant to this paragraph (2).

.03 Correction of a Plan of an Ineligible Employer. The permitted correction of a Plan of an Ineligible Employer under TVC is the cessation of all contributions (including salary reduction and after-tax contributions) beginning no later than the date the application under TVC is filed. Pursuant to TVC correction, the assets in such a plan are to remain in the annuity contract or custodial account and are to be distributed no earlier than the occurrence of one of the distribution events described in ' 403(b)(7) (to the extent the assets are held in custodial accounts) or ' 403(b)(11) (for those assets invested in annuity contracts that would be subject to ' 403(b)(11) restrictions if the employer were eligible). A Plan of an Ineligible Employer that is corrected through TVC will be treated as subject to all of the requirements and provisions of ' 403(b), including the provisions of ' 403(b)(8) (relating to rollovers). Because a Plan of an Ineligible

Employer will be treated as subject to all of the requirements of ' 403(b), the plan must, as part of TVC correction, also correct all other Operational, Demographic, and Eligibility Failures in accordance with this revenue procedure. The correction of a Plan of an Ineligible Employer is subject to the fee described in section 8.04 below (or, with respect to the correction of multiple failures, section 8.05 below).

SECTION 5. SELF-CORRECTION (APRSC)

.01 In general. Except as provided in section 5.02 below, the provisions of Sections 7, 8, and 9 of Rev. Proc. 98-22 generally apply for purposes of self-correcting a 403(b) Plan.

.02 Special rules for APRSC.

(1) APRSC is available to correct Operational Failures, but is not available to correct Demographic Failures or Eligibility Failures.

(2) A plan document is neither necessary nor sufficient to demonstrate that the employer, plan administrator, or insurer has in place established practices and procedures reasonably designed to facilitate overall compliance.

(3) To be eligible for APRSC, there is no requirement that the employer obtain a private letter ruling from the Service covering its 403(b) Plan. Section 4.03 of Rev. Proc. 98-22 does not apply.

(4) APRSC is available to correct Excess Amounts using the method described in section 4.02(1) above, but not the method described in section 4.02(2) above.

(5) To be eligible for APRSC, an employer must have (either directly or, where appropriate, through the insurer or custodian of the annuity contracts or custodial accounts under the 403(b) Plan) compliance practices and procedures in accordance with Section 4.04 of Rev. Proc. 98-22.

(6) APRSC is not available to correct Operational Failures that are egregious, Operational Failures relating to a diversion or misuse of plan assets, or other Operational Failures that are not eligible for correction under APRSC in accordance with Rev. Proc. 98-22.

SECTION 6. TVC PROGRAM

.01 In general. TVC generally allows employers to submit an application requesting correction of one or more Operational Failures, Demographic Failures, or Eligibility

Failures. Under TVC, the employer pays a compliance correction fee, as described in section 8 below, and corrects the failures identified in accordance with the terms of a closing agreement entered into by the Service and the employer. Payment of the compliance correction fee is generally required at the time the closing agreement is signed. Depending on the nature of the failure and the plan's existing administrative procedures, the closing agreement may be conditioned on the implementation of stated administrative procedures.

.02 TVC requirements. The provisions of Rev. Proc. 98-22 relating to Walk-in CAP generally apply to TVC except that TVC applies to Operational Failures, Demographic Failures, and Eligibility Failures in a 403(b) Plan. In addition, there is no requirement that the employer obtain a private letter ruling from the Service covering its 403(b) Plan. Section 4.03 of Rev. Proc. 98-22 does not apply.

.03 Eligibility for TVC. TVC is not available if the 403(b) Plan or the employer is Under Examination.

.04 Failures covered by TVC. TVC is expanded to cover all Operational Failures, Demographic Failures, and Eligibility Failures that are within the jurisdiction of the EP/EO Division of the Key District Office, including Plans of Ineligible Employers. TVC is available to correct egregious failures; however, these failures are subject to the fee described in section 8.06 below. TVC is not available with respect to failures relating to the diversion or misuse of plan assets.

.05 Correction of Excess Amounts. Failures related to Excess Amounts may be corrected under TVC in the manner described in paragraph (1) or (2) of section 4.02 above, and are subject to the fee described in section 8.02 or 8.03, respectively.

SECTION 7. APPLICATION PROCEDURES FOR TVC

.01 In general. The procedures and submission requirements of Section 12 of Rev. Proc. 98-22 apply for purposes of TVC.

.02 Submission requirements. In addition to the submission requirements provided in Section 12.03 of Rev. Proc. 98-22, an application under TVC must contain a statement that the employer has contacted all other entities involved with the plan and has been assured of cooperation in implementing the applicable correction, to the extent necessary. For example, if the plan's failure is the failure to satisfy the requirements of ' 403(b)(1)(E) on elective deferrals, the employer must, prior to making the TVC application, contact the insurance company or custodian with control over the

plan's assets to assure cooperation in effecting a distribution of the excess deferrals and the earnings thereon.

.03 Required documents. A TVC submission must be accompanied by the following documents:

(1) If applicable, the first two pages of the most recently filed Form 5500, or if inapplicable, the information generally included on the first two pages, including the name and number of the plan, and the employer's Employer Identification Number.

(2) A statement as to the type of employer (e.g., a tax- exempt organization described in ' 501(c)(3)) submitting the TVC application.

(3) A copy of the pertinent portions of any relevant ' 403(b) documents such as plan documents, written descriptions of the plan, and sample salary reduction agreements.

(4) The letter to the Service requesting consideration under TVC must be designated "TVC PROGRAM."

(5) TVC submissions must be mailed to the Closing Agreement Coordinator in the appropriate Key District Office as provided in Section 12.12 of Rev. Proc. 98-22.

.04 Checklist. A checklist in Appendix B of Rev. Proc. 98-22 is provided for use by an employer in preparing a TVC request.

SECTION 8. FEES FOR TVC

.01 TVC compliance correction fee. The applicable TVC compliance correction fee depends on the type of failure and, generally, the number of employees of the employer.

.02 Fee for Operational Failures. Subject to section 8.05 below, the compliance correction fees for Operational Failures are as follows:

(1) The fee for an employer with fewer than 25 employees is $ 500.

(2) The fee for an employer with at least 25 and no more than 1,000 employees is $ 1,250.

(3) The fee for an employer with more than 1,000 employees but less than 10,000 is $ 5,000.

(4) The fee for an employer with 10,000 or more employees is $ 10,000.

.03 Fee for certain Excess Amounts. Subject to section 8.05 below, the compliance correction fee for Excess Amounts that are corrected pursuant to section 4.02(2) above is equal to the sum of (1) the applicable fee described in section 8.02 above and (2) two percent of the Excess Amounts, adjusted for earnings through the date of the TVC application, contributed or allocated in the calendar year of the TVC application and in the three calendar years prior thereto. For purposes of determining the fee described in this section 8.03, where there is a failure to satisfy both the ' 403(b)(2) and ' 415 limits with respect to a single employee for a year, the fee will take into account only the greater Excess Amount.

.04 Fee for Demographic and Eligibility Failures.

(1) Subject to section 8.05 below, the compliance correction fee for a 403(b) Plan with failures that include Demographic or Eligibility Failures is determined in accordance with the table set forth below. It is expected that in most instances the compliance correction fee imposed will be at or near the presumptive amount in each range; however, the fee may be a higher or lower amount within the range, depending on the factors in paragraph (2) below. This table is the same as the table provided in Section 13.05 of Rev. Proc. 98-22, except that (a) the reference to the "VCR fee" is changed to refer to the TVC compliance correction fee for Operational Failures set forth in section 8.02 above, and (b) the fee is determined with reference to the number of employees rather than participants.

FEES FOR DEMOGRAPHIC AND ELIGIBILITY FAILURES

# of employees	Fee range	Presumptive Amount
10 or fewer	TVC fee for Operational Failures to $ 4,000	$ 2,000
11 to 50	TVC fee for Operational Failures to $ 8,000	$ 4,000
51 to 100	TVC fee for Operational Failures to $ 12,000	$ 6,000
101 to 300	TVC fee for Operational Failures to $ 16,000	$ 8,000
301 to 1,000	TVC fee for Operational Failures to $ 30,000	$ 15,000
Over 1,000	TVC fee for Operational Failures to $ 70,000	$ 35,000

(2) Consideration of whether the compliance correction fee for a 403(b) Plan with failures that include Demographic or Eligibility Failures should be equal to, greater than, or less than the presumptive amount set forth in section 8.04(1) above will depend on factors relating to the nature, extent, and severity of the failure. These factors include: (a) whether the failure is a failure to satisfy the requirements of ' 401(a)(4), ' 401(a)(26), or ' 410(b) (pursuant to ' 403(b)(12)(A)(i)); (b) whether the plan is a Plan of an Ineligible Employer; (c) whether the 403(b) Plan has a combination of Operational, Demographic, and Eligibility failures; and (d) the period of time over which the failure occurred.

.05 Fee for multiple failures.

If correction is requested for multiple failures, the compliance correction fee will be determined in accordance with the table set forth below.

Multiple Operational Failures	Fee described in section 8.02
MultipleDemographic/Eligibility Failures	Fee described in section 8.04
Combination of Operational and Demographic/EligibilityFailures	Fee described in section 8.04
Operational Failure(s) with section 4.02(2) correction of Excess Amounts	Fee described in section 8.03
Demographic/EligibilityFailures and Operational Failures including section 4.02(2) correction of Excess Amounts	Fee described in section 8.03, substituting section 8.04 fee for section 8.02 fee

.06 Fee for egregious failures. Consistent with section 13.05(3) of Rev. Proc. 98-22, in cases involving failures that are egregious, the maximum compliance correction fee applicable to the plan is increased to 40 percent of the Total Sanction Amount and no presumptive amount applies.

SECTION 9. AUDIT CAP FOR 403(B) PLANS

.01 Audit CAP requirements. The provisions of Sections 14 and 15 of Rev. Proc. 98-22 are expanded to cover 403(b) Plans. Thus, in the event the Service identifies an Operational Failure, Demographic Failure, or an Eligibility Failure upon an Employee Plans or Exempt Organizations examination (other than a failure that has been corrected under APRSC or TVC or that is eligible for correction under APRSC), the

requirements of Section 14 of Rev. Proc. 98-22 are satisfied with respect to the failure if the employer corrects the failure, pays a sanction in accordance with section 9.02 below, adopts appropriate administrative procedures, and enters into a closing agreement with the Service. Audit CAP for 403(b) Plans is not available for failures relating to a misuse or diversion of plan assets.

.02 Payment of sanction. The sanction under Audit CAP for 403(b) Plans is a negotiated percentage of the Total Sanction Amount. Sanctions will not be excessive and will bear a reasonable relationship to the nature, extent, and severity of the failures. The amount of the sanction will depend on factors relating to the nature, extent, and severity of the failures, including the extent to which correction had progressed before the examination was initiated. Other factors relating to the nature, extent, and severity of the failures include:

(1) the number and type of employees affected by the failure;

(2) the number of nonhighly compensated employees who would be adversely affected if the plan were not treated as a plan described in ' 403(b);

(3) whether the failure is a failure to satisfy the requirements of ' 401(a)(4), ' 401(a)(26), or ' 410(b) (pursuant to ' 403(b)(12)(A)(i));

(4) the extent to which the failure relates to Excess Amounts;

(5) whether the plan is a Plan of an Ineligible Employer;

(6) whether the plan has a combination of Operational, Demographic, or Eligibility Failures;

(7) the period over which the failure occurred; and

(8) the reason for the failure (for example, data errors such as errors in transcription of data, the transposition of numbers, or minor arithmetic errors).

SECTION 10. EFFECT ON OTHER DOCUMENTS

.01 Except as provided in section 11 below, the TVC program described in Rev. Procs. 95-24 and 96-50 is modified and superseded by this revenue procedure.

.02 Rev. Proc. 99-8, 1999-1 I.R.B. 229, is modified as provided in section 10 of this revenue procedure.

.03 Rev. Proc. 98-22 is modified and amplified by this revenue procedure.

SECTION 11. EFFECTIVE DATE

The effective date of this revenue procedure is January 1, 1999. However, a TVC application made on or after January 1, 1999 and prior to July 1, 1999 will be reviewed under the guidance provided in Rev. Procs. 95-24 and 96-50, unless the applicant indicates that the TVC application should be reviewed under the guidance provided in this revenue procedure. TVC applications made on and after July 1, 1999 will in all cases be reviewed in accordance with the guidance provided in this revenue procedure.

SECTION 12. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1645.

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

The collection of information in this revenue procedure is in sections 1.01, 4.02, 4.03, 6.01, 6.02, 6.04, 6.05, 7.01-7.04, and 9.01 of this revenue procedure. This information is required to enable the Office of Assistant Commissioner (Employee Plans and Exempt Organizations) of the Internal Revenue Service to make determinations regarding the issuance of various types of closing agreements. This information will be used to issue closing agreements to allow individual plans to continue to maintain their tax qualified status. As a result, favorable tax treatment of the benefits of the eligible employees is retained. The likely respondents are state or local governments and nonprofit institutions.

The estimated total annual reporting and/or recordkeeping burden is 1,899 hours.

The estimated annual burden per respondent/recordkeeper varies from .5 to 12 hours, depending on individual circumstances, with an estimated average of 3.8 hours. The estimated number of respondents and/or recordkeepers is 500.

The estimated frequency of responses is occasionally.

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.

DRAFTING INFORMATION

The principal author of this revenue procedure is Rosamond S. Ferber of the Employee Plans Division. For more information concerning this revenue procedure, call the Employee Plans Division Telephone Number, (202) 622-6074 or (202) 622-6075 (not a toll-free number) between the hours of 1:30 and 4:00 pm, Monday through Thursday. Ms. Ferber may be reached at (202) 622-6214 (also not a toll-free number)