LESSON 2

SELECTED TOPICS UNDER IRC SECTION 415(c), SECTION 415(b), AND SECTION 415(e), AS AMENDED BY GATT, SBJPA, AND THE TAXPAYER RELIEF ACT OF 1997

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CONTENTS

INTRODUCTION

OBJECTIVES

LIMITATION ON ANNUAL ADDITIONS UNDER IRC SECTION 415(c)
- Section 415(c)(1) Limitation
- Cost of Living Adjustments (COLAs)
- Related Employers
- Limitation Year
  - Limitation Year Other Than Calendar Year
  - Limitation On Annual Additions In A Short Limitation Year

COMPENSATION FOR IRC SECTION 415 PURPOSES -- BEFORE AND AFTER SBJPA
- Prior to SBJPA-Compensation Within The Meaning Of Section 415(c)(3)
- SBJPA Amendments To IRC Section 415(c)(3)
- Compensation for Permanently and Totally Disabled Employees
- The Taxpayer Relief Act of 1997 Makes Conforming Changes to Compensation Under Section 403(b)
- Effect Of IRC Section 401(a)(17)

LIMITATION ON BENEFITS UNDER IRC SECTION 415(b)
- Section 415(b)(1) Limitation
- Cost Of Living Adjustments (COLAs)
  - Adjustments of the Dollar Limitation.
  - Adjustments of the Compensation Limitation 21

General Comments
Related Employers
Limitation Year 25
Adjustments Under Section 415(b)(2)
Actuarial Assumptions Used For Adjustments Under Section 415(b)(2)
Prior to GATT
GATT Amendments To IRC section 415(b)(2)(E).
SBJPA Modifies GATT Changes to Section 415(b)(2)(E)
Adjustments For Other Forms Of Benefit
Qualified Joint and Survivor Annuity
Post-Retirement COLAs
Ancillary Benefits
two examples illustrate section 415(b) testing
Adjustments For Commencement Of Benefits Before And After Social Security Retirement Age
Adjustment Of The DB Dollar Limitation Where Benefits Commence Before A Participant's Social Security Retirement Age (SSRA).
Social Security Retirement Age (SSRA).
Commencement Of Benefits Before SSRA, But On Or After Age 62.
Commencement Of Benefits Before Age 62.
Prior to GATT
After GATT and prior to enactment of SBJPA
After GATT as amended by SBJPA
Adjustment Of The DB Dollar Limitation Where Benefits Commence After A Participant's SSRA.
Prior to GATT
Under GATT, as amended by SBJPA
Rev. Rul. 98-1 Provides Guidance And Transition Rules After SBJPA
Old-Law Benefits
Application of Section 415 Limitations Where Section 415(b)(2)(E) Changes Are Not Applied to Old-Law Benefits
Circumstances Under Which Old-Law Benefits Can Change
Plan Funding And Section 415(b)(2)(E) Changes
Draft Memorandum Circulated To The Field
Adjustment
Limitation on reduction-415
Social Security Supplements And IRC Section 415
Special Minimum Benefit Of $10,000
SBJPA And Taxpayer Relief Act of 1997 Amend Section 415(b) Rules Affecting Government Plans

Prior Law
SBJPA Amendments
Taxpayer Relief Act Of 1997 (TRA '97) Amendments

COMBINED PLAN LIMITATIONS UNDER IRC SECTION 415(e)
Limitation Years Beginning Before The Year 2000
Defined Benefit Fraction
Defined Contribution Fraction
GATT AND SBJPA §415 PROCEDURAL MATTERS
Introduction
Remedial Amendment Period
Repealing Amendments Under Section 1449(d) of SBJPA
Operational Compliance with SBJPA and GATT

SUMMARY

INTRODUCTION

Certain provisions of IRC section 415 were significantly affected by provisions of the Uruguay Round Agreements Act, Public Law 103-465 (GATT), the Small Business Job Protection Act of 1996, Public Law 104-188 (SBJPA), and, to a lesser extent, the Taxpayer Relief Act of 1997, Public Law 105-34. In addition to a general discussion of the limitations of IRC 415, this chapter reviews the changes to IRC 415 under these laws and provides examples demonstrating how IRC 415 calculations are affected.

OBJECTIVES

At the end of this lesson you will be able to:

1. For a defined contribution plan, determine whether the correct employer(s), limitation year, and section 415(c)(3) compensation are used for section 415 purposes;

2. For a defined benefit plan, determine whether, in applying the limitations of section 415(b), the correct section 415(b) limitation is used, adjusted as necessary for early or late commencement and less than 10 years of participation (or service, as applicable); and

3. For limitation years beginning before the year 2000, where an employee

is a participant in a defined contribution plan and a defined benefit plan maintained by the same employer, determine whether the combined plan limitations of IRC section 415(e) are applied correctly.

LIMITATION ON ANNUAL ADDITIONS UNDER IRC SECTION 415(c)

Defined contribution plans, defined in IRC sections 415(k) and 414(i), include money purchase plans, stock bonus plans, profit-sharing plans, target benefit plans, ESOPs, PAY-SOPs, tax-sheltered annuities and contracts (as described in IRC sections 403(a) and (b)), and simplified employee pensions (SEPs, as described in IRC section 408(k)). Individual retirement accounts or annuities under sections 408(a) and (b) are not included as plans subject to section 415 for years after 1981. A hybrid plan, as defined in section 414(k), is treated as a defined contribution plan for section 415 purposes to the extent that plan benefits are based on the separate accounts of the participants.

Section 415(c)(1) Limitation

The limitation applicable to defined contribution plans, stated in IRC section 415(c)(1), limits the amount of annual additions which may be contributed to an individual's account(s) in all defined contribution plans maintained by the employer in any one year to the lesser of

(A) $30,000, or

(B) 25 percent of the participant's compensation.

Section 1.415-1(d) of the Income Tax Regulations (Reg.) provides that the terms of a qualified plan must preclude the possibility that the limitations imposed by IRC section 415 will be exceeded.

IRC section 415(c) also takes into account amounts that are contributed under certain other types of qualified plans and nonqualified plans. All employee contributions (except for rollovers) to defined benefit plans (whether mandatory or voluntary and whether or not held in a separate account) are treated as a separate defined contribution plan and are annual additions for section 415 purposes. Also included as annual additions for testing the dollar limitation (but not the percentage of compensation limitation) of section 415(c) are amounts allocated to any individual medical account which is part of a pension or annuity plan described under IRC sections 415(l) and 401(h), and amounts contributed for key employees

to separate accounts for post-retirement medical or life insurance benefits as provided under IRC section 419A(d).

Cost of Living Adjustments (COLAs)

When section 415 was added to the Internal Revenue Code by ERISA, the rules under section 415(d) provided for cost-of-living adjustments to the dollar limitation of section 415(c)(1)(A). With such adjustments, the DC dollar limit increased to $45,475 for 1982. TEFRA generally reduced the DC dollar limit to $30,000 for 1983 and froze COLAs through 1985. TRA '84 extended the freeze extended through 1987. TRA '86 tied the adjustment of the DC dollar limitation to the section 415(b)(1)(A) dollar limitation (the DC dollar limit was equal to the greater of $30,000 or 1/4 of the DB dollar limit), and this linkage was effective from 1987 through 1994.

For years after 1994, GATT removed the linkage of the DC dollar limit to the DB dollar limit and provided for a separate adjustment to the DC dollar limit, with such adjustment based on increases in the applicable index for the third calendar quarter of the previous year taking into account the calendar quarter beginning October 1, 1993, as the base period. Additionally, GATT provided that any increase in the DC dollar limit amount which is not a multiple of $5,000 is rounded to the next lowest multiple of $5,000.

The IRC section 415(c)(1)(A) dollar limitations in effect following ERISA to 1998 are given below.

IRC SECTION 415(c)(1)(A) DOLLAR LIMITATIONS

ERISA--$25,000 for years beginning in 1976, to be adjusted for COLAs

Effective Jan. 1, 1976	$26,825
Jan. 1, 1977	28,175
Jan. 1, 1978	30,050
Jan. 1, 1979	32,700
Jan. 1, 1980	36,875
Jan. 1, 1981	41,500
Jan. 1, 1982	45,475
Effective Jan. 1, 1983-1998	30,000

Related Employers

IRC sections 414(b), (c), and (m) provide that for purposes of IRC section 415 all employees of all corporations which are members of a controlled group of corporations, all employees of trades or businesses (whether or not incorporated) which are under common control, and all employees of the members of an affiliated service group are treated as employed by a single employer. IRC section 415(h) provides that for purposes of applying IRC sections 414(b) and (c), the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in IRC section 1563(a)(1).

IRC section 414(n) provides that, for purposes of IRC section 415, a leased employee is treated as an employee of the recipient of the leased employee's services. In particular, benefits or contributions provided by the leasing organization which are attributable to services performed for the recipient are treated as provided by the recipient.

EXAMPLE (1):

Company A maintains a money purchase pension plan and a profit sharing plan covering the same group of employees. For purposes of IRC section 415(c), these two plans are treated as one plan, and the combined annual additions for each participant under both plans cannot exceed the limitation of IRC section 415(c).

It is important to note that where a company was a member of a controlled group, or affiliated service group, as described above, which maintained a plan and the company subsequently leaves the group and establishes an unrelated new plan, the plan of the prior group is aggregated with the company's new plan for purposes of applying the limitations of IRC section 415. (See Reg. section 1.415-8(a).

EXAMPLE (2):

Companies A, B, and C are members of a controlled group of corporations. Employees of all members of the controlled group are eligible to participate in a defined contribution plan, Plan X. The plan year and the limitation year for Plan X are both the calendar year.

On June 30, 1997, Company A ceases membership in the controlled group (after the purchase of 90% of its stock by a nonrelated company), and immediately establishes a new defined contribution plan, Plan Y, and a defined benefit plan, Plan Z, for its

employees. Plans Y and Z both have a calendar year plan year and limitation year. No transfers of assets and liabilities within the meaning of IRC section 414(l) are made from Plan X to the new Plan Y.

For the 1997 limitation year, contributions to both plans X and Y would be aggregated for purposes of applying the limitations of IRC section 415(c) (Company A would be treated as maintaining both plans). Additionally, for purposes of applying the limitation of IRC section 415(e) to the 1997 limitation year (and subsequent limitation years beginning before 2000), the defined contribution fractions for those employees of Company A who have participated in Plans X and Y would include all contributions made on behalf of these employees under Plan X and under Plan Y.

Examination Steps

1. Determine all DC and DB plans that are currently maintained by the employer (or have ever been maintained by the employer), along with their effective dates and earliest participation dates.

2. Determine whether or not the employer is a member of any controlled group of corporations, a member of trades or businesses (whether or not incorporated) which are under common control, or a member of an affiliated service group. Taking IRC section 415(h) into account, determine whether the employer is treated with other members of these groups as a single employer for purposes of applying the limitations of IRC section 415. If other members are to be taken into account, determine the same information for their plans as that determined for the employer.

Limitation Year

The limitation on annual additions is applied to a "limitation year," which is the calendar year unless another consecutive 12 month period is elected by the employer. The definition and special rules for limitation year are given in Reg. section 1.415-2(b).

Limitation Year Other Than Calendar Year

The election to use any other consecutive twelve month period as the limitation year (other than the calendar year) or to change the limitation year is made by the adoption of a written resolution by the employer. This election can also be made in connection with the adoption, by the employer, of the plan or any amendments to such plan. Once the limitation year is established, it may only be changed by one of the election methods described above. If a change is so made, the new limitation year must be a twelve-consecutive month period which begins on any day within the prior limitation year, with the effect that a short limitation year is created. (See Reg. section 1.415-2(b)(4).)

As a general rule, a group of employers which constitute a controlled group of corporations, commonly controlled trades or businesses or affiliated service groups, within the meaning of IRC sections 414(b),(c), or (m), must all make the same election with respect to the limitation year. An employer that maintains more than one qualified plan must generally use the same limitation year for each plan. However, the employer that maintains more than one plan, or the group of employers described above, may elect to use different limitation years as prescribed by Rev. Rul. 79-5, 1979-1 C.B. 165. This Rev. Rul. is designed to provide relief in the case of two or more large plans of the same employer with accounting systems based on different plan years, and few, if any, participants covered by more than one plan. The rules are complex and somewhat more restrictive than the general case.

Limitation On Annual Additions In A Short Limitation Year

If the employer changes the limitation year, a short limitation year is created which begins on the first day of the current limitation year and ends on the day before the first day of the new limitation year. For defined contribution plans, but not for defined benefit plans, where a short limitation year is created because of a change in limitation years, the dollar limitation applicable to the short limitation year is prorated.

The limitation on annual additions is applied to the new limitation year in the normal manner. However, for defined contribution plans only, the dollar limitation for the short limitation year is prorated by multiplying the defined contribution dollar limitation in effect for the calendar year in which the short limitation year ends by the following fraction (where the numerator includes fractional parts of a month):

$$\frac{\text{number of months in short limitation year}}{12}$$

In applying the limitations of section 415(c) to the short limitation period, the amount of compensation taken into account may only include compensation paid (or accrued where applicable) for this period. (See Reg. section 1.415-2(b)(4).)

The short limitation year requirements apply only to changes in the limitation year. For a new participant, the dollar and percentage of compensation limitations of IRC section 415(c) in effect for their first limitation year, even if participation commences during the year, is always an entire year's dollar limitation and the applicable percentage of an entire limitation year's compensation, including compensation prior to participating (similarly for those who cease participation during a limitation year or for plans that begin or terminate during a limitation year).

EXAMPLE (3): Under Plan X, a profit-sharing plan, the calendar year is the limitation year. On June 30, 1996, the plan is amended to change the limitation year to a July 1 to June 30 year. Therefore, the new limitation year begins July 1, 1996, and a short limitation year is created (Jan. 1, 1996, to June 30, 1996).

Since the short limitation year ends in 1996, a calendar year for which the section 415(c)(1) dollar limitation is $30,000, the dollar limitation for the short limitation period is:

$$\$30,000 \times \frac{6}{12} = \$15,000$$

Therefore, annual additions allocated in the short limitation year cannot exceed the lesser of:

(1) 25% of IRC section 415 compensation earned (or accrued where applicable) during the short limitation year, or

(2) $15,000.

The new limitation year ends June 30, 1997. The limitation on allocations for the new limitation year will be the lesser of:

(1) 25% of IRC section 415 compensation for the new limitation year, or

(2) $30,000.

Examination Steps

1. What is the limitation year for each plan? If the employer has elected to use a 12 consecutive month period other than the calendar year, was the election effected by one of the three methods discussed under the definition of limitation year (i.e., separate written resolution, adoption of a plan with a limitation year other than a calendar year, or adoption of a plan amendment changing the limitation year)?

2. If the limitation year has been changed and a short limitation year is created, has a prorated dollar limitation been used for the short limitation year? For purposes of determining the compensation limitation which applies for the short limitation year, has compensation earned (or accrued as applicable) during the short limitation year been used?

COMPENSATION FOR IRC SECTION 415 PURPOSES -- BEFORE AND AFTER SBJPA

While the terms of a plan may provide a different definition of compensation for purposes of calculating the rate of employer contributions for defined contribution plans or the benefit accrual for defined benefit plans, a definition of compensation within the meaning of IRC section 415(c)(3) must be used to determine whether the maximum permissible contributions or benefits have been exceeded. Three possible ways to define "compensation within the meaning of IRC section 415(c)(3)" are enumerated in Reg. section 1.415-2(d). A plan that incorporates section 415 by reference must specify which definition of compensation is incorporated. **It is important to note that this regulation has not been amended to incorporate changes made to IRC section 415(c)(3) by SBJPA, generally effective for years beginning after 1997.**

Prior to SBJPA--Compensation Within The Meaning Of Section 415(c)(3)

For limitation years beginning before 1998 (when SBJPA changes to section 415(c)(3) become effective) compensation within the meaning of IRC section 415(c)(3) can be defined in one of three possible ways: the "traditional" IRC section 415(c)(3) definition of compensation which includes all remuneration found in Reg. section 1.415-2(d)(2) and excludes all other forms of remuneration, including exclusions listed in Reg. section 1.415-2(d)(3); and two "alternative definitions" used for wage reporting purposes, as modified, which will be

considered automatically to satisfy IRC section 415(c)(3).

1. "Traditional" IRC section 415(c)(3) compensation.

For purposes of applying the limitations of IRC section 415, the term compensation includes all of the following inclusions and does not include any other form of remuneration.

The **inclusions** are:

(i) wages, salaries, fees for professional services, and other amounts received (without regard to whether or not an amount is paid in cash) for personal services actually rendered in the course of employment with the employer maintaining the plan to the extent that the amounts are includible in gross income (including, but not limited to, commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, bonuses, fringe benefits, and reimbursements or other expense allowances under a nonaccountable plan (as described in Reg. section 1.62-2(c));

(ii) earned income in the case of a self-employed individual (see IRC sections 401(c)(1) and (2) for definitions);

(iii) amounts described in IRC sections 104(a)(3), 105(a), and 105(h), but only to the extent that these amounts are includible in the gross income of the employee;

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

(v) the value of a non-qualified stock option granted to an employee by the employer, but only to the extent that the value of the option is includible in the gross income of the employee for the taxable year in which granted; and

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

In determining amounts under (i) and (ii) above, foreign earned income (as defined

in IRC section 911(b)), whether or not excludible from gross income under IRC section 911, is included. Compensation under (i) above is to be determined without regard to the exclusions from gross income in IRC sections 931 and 933. (See Reg. section 1.415-2(d)(2).)

Examples of remuneration **not included** in compensation are:

(i) contributions made by the employer to a plan of deferred compensation to the extent that, before the application of the IRC section 415 limitations to that plan, the contributions are not includible in the gross income of the employee for the taxable year in which contributed;

(ii) employer contributions made on behalf of an employee to a simplified employee pension described in IRC section 408(k);

(iii) any distributions from a plan of deferred compensation, regardless of whether such amounts are includible in the gross income of the employee when distributed, although amounts received from an unfunded nonqualified plan are permitted to be considered as compensation for IRC section 415 purposes in the year the amounts are includible in the employee's gross income;

(iv) amounts realized from the exercise of a non-qualified stock option or when restricted stock (or property) held by an employee either becomes freely transferable or is no longer subject to a substantial risk of forfeiture (see IRC section 83 and the regulations thereunder);

(v) amounts realized from the sale, exchange or other disposition of stock acquired under a qualified stock option; and

(vi) other amounts which receive special tax benefits, such as premiums for group-term life insurance (but only to the extent that the premiums are not includible in the gross income of the employee), or contributions made by an employer (whether or not under a salary reduction agreement) towards the purchase of an annuity contract described in IRC section 403(b) (whether or not the contributions are excludible from the gross income of the employee).

Safe Harbor Definition.

If a plan defines compensation for purposes of applying the limitations of IRC section 415 to include only those items specified in Reg.section 1.415-2(d)(2)(i) and to exclude all those items listed in Reg. section 1.415-2(d)(3), if applicable, the plan will automatically be considered to be using a definition of compensation which satisfies IRC section 415(c)(3).

Alternatively, for employees other than self-employed individuals treated as employees within the meaning of IRC section 401(c)(1), a plan may define compensation using definitions (2) and (3) below, used for wage reporting purposes, as modified herein, and the definition will be considered automatically to satisfy IRC section 415(c)(3).

2. IRC section 3401(a) wages

Compensation is defined as wages within the meaning of IRC section 3401(a) (for purposes of income tax withholding at the source) but determined without regard to any rules that limit the remuneration included in wages based on the nature or location of the employment or the services performed (such as the exception for agricultural labor in IRC section 3401(a)(2)).

3. Information required to be reported under IRC sections 6041, 6051, and 6052

Compensation is defined as wages within the meaning of IRC section 3401(a) and all other payments of compensation to an employee by his employer (in the course of the employer's trade or business) for which the employer is required to furnish the employee a written statement under IRC sections 6041(d), 6051(a)(3), and 6052. (See sections 1.6041-1(a), 1.6041-2(a)(1), 1.6052-1, and 1.6052-2, and also IRC section 31.6051-1(a)(1)(i)(C).) This definition of compensation may be modified to exclude amounts paid or reimbursed by the employer for moving expenses incurred by an employee, but only to the extent that at the time of the payment it is reasonable to believe that these amounts are deductible by the employee under IRC section 217. Under this alternative definition, compensation must be determined without regard to any rules under IRC section 3401(a) that limit the remuneration included in wages based on the nature or location of the employment or the services performed (such as the exception for agricultural labor in IRC section 3401(a)(2)).

General Comments

Thus, for years beginning prior to 1998, compensation **for section 415**

purposes does not include amounts which are deferred and not includible in gross income under IRC sections 125, 401(k) (see IRC section 402(a)(8)), 403(b), and 408(k) (see IRC section 402(h)). However, you should note that compensation **for purposes of section 414(s)** may include (by employer election) amounts contributed by the employer pursuant to a salary reduction agreement and which are not includible in an employee's gross income under IRC sections 125, 402(a)(8), 402(h), or 403(b). Therefore, nontaxable deferred income which is not included in compensation for purposes of section 415 may be added back into the compensation figure for purposes of nondiscrimination testing where the employer is using the general definition of compensation (section 415(c)(3) compensation) under section 414(s).

The plan must provide a definition of compensation actually paid or includible in gross income in the year. For limitation years beginning before January 1, 1992, the employer may elect to use compensation accrued for the limitation year, but all members of a controlled group of corporations or an affiliated service group (within the meaning of IRC sections 414(b), 414(c), or 414(m) as modified by section 415(h)) must make the same election.

If an employee is employed by two or more members of a controlled group of corporations, members of commonly controlled trades or businesses or an affiliated service group, compensation for such employee includes compensation from all of the employers in the group, whether or not they maintain the plan.

SBJPA Amendments To IRC Section 415(c)(3)

SBJPA added section 415(c)(3)(D) to the Code which provides that a participant's compensation includes (i) any elective deferral (as defined in section 402(g)(3)), and (ii) any amount which is contributed or deferred by the employer at the election of the employee and which is not includible in the gross income of the employee by reason of section 125 or 457. This section applies to years beginning after December 31, 1997. Thus, **for years beginning after 1997**, elective deferrals to section 401(k) plans and similar arrangements (employer contributions, to the extent not includible in gross income, to SEPs; employer contributions to purchase a section 403(b) annuity contract under a salary reduction agreement; and contributions to a simple retirement account under a salary reduction arrangement), elective contributions to non-qualified deferred compensation plans

of tax-exempt employers and State and local governments (section 457 plans), and salary reduction contributions to a cafeteria plan are considered compensation for purposes of the limits on contributions and benefits.

SBJPA included conforming amendments, effective for years beginning after 1997, to provide that (i) under section 414(q)(4), for purposes of that section, the term "compensation" has the meaning given such term by section 415(c)(3), and (ii) under section 414(s)(2), an employer may elect not to include as compensation any amount which is contributed by the employer pursuant to a salary reduction agreement and which is not includible in the gross income of an employee under sections 125, 402(e)(3), 402(h), or 403(b).

EXAMPLE (4):

Employer Y maintains a profit sharing plan with an IRC section 401(k) cash or deferred arrangement for a group of employees. During a given limitation year, Employee Smith received a $500 allocation under the profit sharing plan and elected to defer $3,500 under the section 401(k) cash or deferred arrangement, of which $2,000 was matched by the employer. Smith's salary for the year (including the $3,500 elective deferral) was $35,000, and Smith received no other remuneration includible in compensation under section 1.415-2(d).

If the plan year and limitation year are both the calendar year 1996, for purposes of applying the limitations of section 415(c), compensation of $31,500 ($35,000 - $3,500) is used for Smith. Therefore, the compensation limitation applicable to Smith is $7,875 (25 percent of $31,500). This is because elective section 401(k) contributions are not treated as compensation under any of the allowable definitions of compensation under IRC section 415. Smith's total annual addition of $6,000 ($500 + $3,500 + $2,000) under the profit sharing plan did not exceed the dollar limitation ($30,000) or the percentage of compensation limitation ($7,875) applicable to Smith.

If the plan year and limitation year were the calendar year 1998, Smith's entire compensation of $35,000 would be used and the compensation limitation applicable to Smith would be $8,750 (25 percent of $35,000) and, again, Smith's annual addition would not exceed this limitation.

Compensation for Permanently and Totally Disabled Employees

Section 415(c)(3)(C) provides that in the case of a participant in a DC plan (i) who is permanently and totally disabled, (ii) who is not a highly compensated employee (within the meaning of section 414(q)), and with respect to whom the employer elects to have this subparagraph apply, the term "participant's compensation" means the compensation the participant would have received for the year if the participant was paid at the rate of compensation paid immediately before becoming permanently and totally disabled. Amounts contributed and treated as compensation under section 415(c)(3)(C) must be nonforfeitable when contributed. SBJPA amended this section to provide that, for years beginning after 1996, where the plan provides for the continuation of contributions on behalf of **all** participants described in section 415(c)(3)(D)(i) for a fixed or determinable period, the section is applied without regard to clauses (ii) and (iii). That is, if the DC plan provides for the continuation of contributions on behalf of **all** participants who are permanently and totally disabled, then the special rule for contributions on behalf of disabled employees is applicable without an employer election, and applies to both highly compensated and nonhighly compensated employees.

The Taxpayer Relief Act of 1997 Makes Conforming Changes to Compensation Under Section 403(b)

Section 403(b)(3) (defining includible compensation) was amended by the Taxpayer Relief Act of 1997 to conform to the changes made to the definition of section 415(c)(3) compensation. This section was amended to provide that, for years beginning after 1997, includible compensation includes any elective deferral (as defined in section 402(g)(3), and any amount contributed or deferred by the employer at the election of the employee and which is not includible in the employee's gross income by reason of section 125 or 457.

Effect Of IRC Section 401(a)(17)

TRA '86 added IRC section 401(a)(17) which imposes an annual compensation limit on the amount of compensation a qualified plan can take into account in determining allocations, in a defined contribution plan, or benefit accruals, in the case of a defined benefit plan. You should note that for purposes of applying the percentage of compensation limitations of IRC section 415, compensation is not limited by the IRC section 401(a)(17) compensation limit. However, the benefits and contributions to which the IRC section 415 limitations are applied cannot be based on compensation in excess of the IRC section 401(a)(17) compensation limit.

It should be noted that for purposes of applying the limitations of IRC section 415, the family aggregation rules found in IRC sections 401(a)(17) and 414(q)(6) do not apply. That is, after each family member's benefit has been computed taking into account any applicable family aggregation rules, the resulting individual benefit is separately compared to the lesser of (1) the full dollar limitation of IRC section 415(b)(1)(A) (as adjusted for benefit form and commencement age) or (2) high-three average compensation for the individual based on that individual's full compensation for the applicable years. For this purpose, compensation of other family members is not aggregated with the individual participant's compensation. **Note that SBJPA repealed section 414(q)(6) and amended section 401(a)(17)(A) to strike the reference to family aggregation for years beginning after 1996.**

EXAMPLE (5):

Mr. Smith was hired as a vice president for Company S at the beginning of 1995, with compensation for 1995 of $200,000. Mr. Smith immediately became a participant in a money purchase pension plan (Plan A), the only plan maintained by Company S for its employees. The contribution formula under Plan A is 15% of compensation, and the plan year and limitation year for Plan A are both the calendar year. Given that the section 415(c)(1)(A) limit for 1995 is $30,000, and the section 401(a)(17) limit for 1995 is $150,000, what amount can be allocated to Mr. Smith's account for 1995?

SOLUTION: In calculating Mr. Smith's allocation for 1995, compensation must be limited to $150,000. Thus, the allocation before limitation for section 415 would be calculated as 15% x $150,000 = $22,500. The section 415(c) limitation applicable to Mr. Smith for 1995 would be the lesser of (i) $30,000 or (ii) 25% of $200,000 (actual compensation) = $50,000. The lesser amount is $30,000. The allocation of $22,500 does not exceed the limitation of section 415(c).

EXAMINATION STEPS

1. (a) Is an IRC section 415 definition of compensation used under the plan for purposes of determining whether the limitations of IRC section 415 have been exceeded?

(b) Does the plan specify which definition is used for purposes of determining section 415(c)(3) compensation?

2. Are amounts which are deferred and not includible in gross income under section 125 plans, section 401(k) plans, section 403(b) plans, section 408(k) plans, and section 457 plans excluded from compensation for section 415 testing in years prior to 1998, and included in compensation in years after 1997?

3. Is the employee's compensation from all members of a controlled group taken into account?

LIMITATION ON BENEFITS UNDER IRC SECTION 415(b)

A defined benefit (DB) plan within the meaning of IRC section 414(j) is any plan which is not a defined contribution plan. Under a defined benefit plan, participants accrue a benefit each year under a formula which must be explicitly stated in the plan. (See Reg. section 1.401-1(b)(1)(i) and Reg. sections 1.401(a)-1(b)(1)(i) and (iii).) "Accrued benefit," generally, refers to pension or retirement benefits and not to ancillary benefits not directly related to retirement benefits.

Section 415(b)(1) Limitation

IRC section 415(b) limits the annual benefit that can be accrued or paid to a participant under a defined benefit plan to the lesser of :

(A) $90,000, or

(B) 100 percent of the participant's average compensation for his (or her) high 3 years.

Cost Of Living Adjustments (COLAs)

Adjustments of the Dollar Limitation.

IRC section 415(d) provides that the dollar limitation ($90,000) of section 415(b)(1)(A) is adjusted annually by the Secretary of the Treasury to take into account increases in the cost of living, with the adjusted limitation effective as of January 1 of a calendar year and **applicable to limitation years ending with or within that calendar year**.

The adjusted dollar limitation is applicable to participants in a defined benefit plan and to employees who have retired or otherwise terminated their service under the plan with a nonforfeitable right to accrued benefits, regardless of whether they have actually begun to receive such benefits. However, the annual benefit payable to a terminated participant, which is otherwise limited by the dollar limitation, may be increased in accordance with cost-of-living adjustments to the dollar limitation **only if the plan specifically provides for such scheduled post-retirement adjustments**.

While a defined benefit plan may include a provision which automatically adjusts the maximum dollar limitation for changes in the cost-of-living, the provision may only provide for increases scheduled under the plan terms which become effective as provided in section 415(d) no sooner than January of each calendar year. Stated differently, increases in the dollar limitation may not be anticipated.

Prior to ERISA, the limitation on benefits was, in general, 100% of compensation. (See Rev. Rul. 72-3.) With COLA adjustments, the DB dollar limit grew to $136,425 for 1982. The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) reduced the DB dollar limitation to $90,000, and imposed a 3-year freeze on the cost-of-living adjustments to the DB dollar limitation, beginning in 1983. The Tax Reform Act of 1984 (TRA '84) extended the freeze on COLAs until January 1, 1988.

For years beginning after 1994, GATT changed the quarter (from the fourth calendar quarter to the third calendar quarter) used for determining increases in the applicable index which, taking into account the index for the applicable base period, is used to calculate COLA adjustments under section 415(d) (using adjustment procedures similar to those used to adjust benefit amounts under section 215(i)(2)(A) of the Social Security Act).

GATT also provided that any increase in the DB or DC dollar limitation which is not a multiple of $5,000 is rounded to the next lowest multiple of $5,000.

The base periods specified by GATT for adjustments under section 415(d) are: (1) the calendar quarter beginning October 1, 1986, for adjustments to the DB dollar limitation; (2) for adjustments to the DB compensation limitation for participants separated from service after 1994, the calendar quarter beginning July 1 of the calendar year preceding the calendar year in which separation occurs; (3) for adjustments to the DB compensation limitation for participants separated from service before 1995, the calendar quarter beginning October 1 of the calendar year preceding the calendar year in which separation occurs; and (4) for adjustments to the DC dollar limitation, the calendar quarter beginning October 1, 1993.

The DB dollar limitations in effect from the passage of ERISA through 1998 are given below.

IRC Section 415(b)(1)(A) Dollar Limitation

Limitation as added by ERISA	$ 75,000
Jan. 1, 1976	$ 80,475
Jan. 1, 1977	$ 84,525
Jan. 1, 1978	$ 90,150
Jan. 1, 1979	$ 98,100
Jan. 1, 1980	$110,625
Jan. 1, 1981	$124,500
Jan. 1, 1982	$136,425
Jan. 1, 1983--Jan. 1, 1987	$ 90,000
Jan. 1, 1988	$ 94,023
Jan. 1, 1989	$ 98,064
Jan. 1, 1990	$102,582
Jan. 1, 1991	$108,963
Jan. 1, 1992	$112,221
Jan. 1, 1993	$115,641
Jan. 1, 1994	$118,800
Jan. 1, 1995	$120,000
Jan. 1, 1996	$120,000
Jan. 1, 1997	$125,000
Jan. 1, 1998	$130,000

Adjustments of the Compensation Limitation.

In certain circumstances the compensation limitation applicable to a participant who has separated from service with a nonforfeitable right to an accrued benefit may be adjusted annually to take into account increases in the cost of living. Specifically, where the annual benefit payable to a terminated participant is limited by the compensation limitation and **where the plan specifically provides for such post-termination adjustments**, the compensation limitation applicable to the participant in the limitation year he or she separated from service may be adjusted.

The factors used to adjust the compensation limitation applicable to a separated participant for the calendar years from 1995 through 1998 are given below. For a participant who has separated from service, the compensation limitation for a calendar year is computed by multiplying the compensation limitation applicable to the individual, as adjusted under prior law through the prior calendar year, by the annual adjustment factor provided by the Service for that year.

1995	1.0217
1996	1.0264
1997	1.0294
1998	1.0220

General Comments.

For individuals whose benefits under a plan are limited by section 415(b) and the plan provides for the escalation of benefits as the section 415(b) limitation is increased, benefits may only be increased beginning in the limitation year the increased section 415(b) limitation becomes effective, and benefits for prior years are not retroactively increased because of benefit increases in the current year.

For purposes of calculating a single-sum distribution of a participant's benefit, COLA increases in the dollar limitation and the compensation limitation must not be anticipated. Where a plan formula provides that a participant's benefit is increased each year by a COLA which is a function of the Consumer Price Index (CPI), participants receiving their benefit in the form of a single sum must receive projections of the CPI increases (based on reasonable actuarial assumptions) as part of their single sum, but only to

the extent that the single sum does not exceed the actuarial present value of the lesser of the current dollar limitation or current compensation limitation applicable to the participant.

EXAMPLE (6):

Company A has a DB plan, Plan Z, with a plan year and limitation year that both end on June 30. What is the DB dollar limitation applicable to a participant in Plan Z for the limitation year ending June 30, 1997?

Solution. The dollar limitation applicable to the July 1, 1996, to June 30, 1997, limitation year is $125,000. The adjusted dollar limitation effective January 1, 1997, is applicable to limitation years ending with or within the calendar year 1997. (See Reg. section 1.415-3(a)(2).)

EXAMPLE (7):

A DB plan, Plan Y, with a calendar year plan year and limitation year was terminated on August 10, 1996, but was not able to make single-sum distributions to participants until February of 1997. Which adjusted dollar limitation will be used for purposes of calculating the maximum single sum-distribution which can be distributed to a participant of Plan Y?

SOLUTION: The dollar limitation in effect on the date of termination ($120,000) would be used for calculating the maximum accrued benefit under the plan in an optional form, i.e., the maximum single sum which can be distributed. If the plan provides for interest on late distributions, the amount may be increased accordingly (provided that such amount does

not exceed the limitation in effect on the date of distribution).

EXAMPLE (8):

In 1993, Mr. Burton retired from Plan K, a defined benefit plan, at his social security retirement age of 65. His benefit at retirement age, prior to limitation for section 415(b), was $150,000 per year, payable as a joint and 50% survivor annuity. Mr. Burton's benefit in 1993 was limited by section 415(b) to $115,641. The terms of Mr. Burton's plan do not provide for automatic post-retirement increases as the section 415 dollar limitation increases. However, in 1996, the plan provides for a 2% cost of living adjustment for all of its retirees. Under the terms of the plan, ad hoc COLA adjustments for retirees are calculated using benefits under the plan formula, prior to limitation for section 415. How will this affect Mr. Burton's benefit in 1996?

SOLUTION: In 1996, Mr. Burton can receive a 2% increase in his benefit, provided that the increase will not cause the 1996 section 415(b) limitation to be exceeded. Therefore, in 1996 Mr. Burton's benefit would be computed as $153,000 (1.02 x $150,000) which would then be limited to $120,000 (the 1996 section 415(b) limitation).

Related Employers

IRC sections 414(b), (c), and (m) provide that for purposes of IRC section 415 all employees of all corporations which are members of a controlled group of corporations, all employees of trades or businesses (whether or not incorporated) which are under common control, and all employees of the members of an affiliated service group are treated as employed by a single employer. IRC section 415(h) provides that for purposes of applying IRC sections 414(b) and (c), the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in IRC section 1563(a)(1).

See "Related Employers" under "Limitation on Annual Additions Under IRC Section 415(c)" for further discussion of this topic.

Limitation Year

The limitation on benefits is applied to a "limitation year," which is the calendar year unless another consecutive 12 month period is elected by the employer. The definition and special rules for limitation year are given in Reg. section 1.415-2(b).

The election to use any other consecutive twelve month period as the limitation year (other than the calendar year) or to change the limitation year is made by the adoption of a written resolution by the employer. This election can also be made in connection with the adoption, by the employer, of the plan or any amendments to such plan. Once the limitation year is established, it may only be changed by one of the election methods described above. If a change is so made, the new limitation year must be a twelve-
consecutive month period which begins on any day within the prior limitation year, with the effect that a short limitation is created. (See Reg. section 1.415-2(b)(4).)

See "Limitation Year" under "Limitation on Annual Additions Under IRC Section 415(c)" for further discussion of this topic.

EXAMINATION STEPS:

1. Is the correct IRC 415(b) dollar limitation being used for purposes of applying the limitations of IRC 415? Where a DB plan is terminated in one limitation year and benefits in the form of a single sum are not distributed until the following limitation year, is the correct IRC 415(b) limitation (the limitation in effect at the time of termination) used for demonstrating satisfaction of the IRC 415 limitations?

2. Where benefits of retired participants (with benefits limited by either the DB dollar limitation or the DB compensation limitation) are increased as the IRC 415(b) dollar limitation increases or as new factors published by the Service for adjusting the compensation limitation applicable to a separated participant become effective, do the terms of the plan specifically provide for such post-retirement increases?

Adjustments Under Section 415(b)(2)

The limitations under section 415(b)(1) are applied to a participant's "annual benefit" which is a benefit that is payable annually in the form of a straight life annuity (with no ancillary benefits). The section 415(b) limitations are applied to the employer-provided portion of an employee's benefit. Annual benefit is further defined in section 415(b)(2)(A) and in regulation section 1.415-3(c).

When applying the section 415(b) limitations to a participant's benefit, adjustments to the participant's benefit or to the limitation applicable to the participant's benefit may be required. Where a participant's benefit is payable in a form other than a straight life annuity, section 415(b)(2)(B) provides that the benefit (except for those forms for which no adjustment is required) is adjusted to an equivalent benefit in the form of a straight life annuity, commencing at the same age. Section 415(b)(2)(C) provides for adjustment of the dollar limitation where a benefit begins before social security retirement age (SSRA), and section 415(b)(2)(D) provides for adjustment of the dollar limitation where a benefit begins after SSRA.

Actuarial Assumptions Used For Adjustments Under Section 415(b)(2)

The interest and mortality assumptions used for purposes of adjustments under sections 415(b)(2)(B), (C), and (D) must satisfy the rules under section 415(b)(2)(E). Section 415(b)(2)(E) was amended by the Retirement Protection Act of 1994 (RPA '94) portion of GATT, and by SBJPA.

Prior to GATT.

Prior to GATT, section 415(b)(2)(E)(i) provided that for purposes of adjusting any benefit or limitation under section 415(b)(2)(B) or (C), the interest rate assumption used must not be less than the greater of 5 percent or the rate specified in the plan. The specific plan rate is the rate used under the plan for actuarial equivalence for that specific benefit form. Note, some plans may specify different rates for different benefit forms. Prior to GATT, section 415(b)(2)(E)(ii) provided that for purposes of adjusting any limitation under section 415(b)(2)(D), the interest rate assumption must not be greater than the lesser of 5 percent or the rate specified in the plan. (The mortality table used for adjustments under section 415(b)(2) is generally the table used for actuarial equivalence for the specific benefit form under the plan, but the plan is permitted to specify another reasonable mortality table for this purpose.)

GATT Amendments To IRC section 415(b)(2)(E).

Section 767(b) of the Retirement Protection Act (RPA '94) portion of GATT, amended section 415(b)(2)(E)(i) to provide that, except as provided in clause (ii), for purposes of adjusting any benefit or limitation under sections 415(b)(2)(B) or (C), the interest rate assumption must not be less than the greater of 5 percent or the rate specified in the plan. Section 415(b)(2)(E)(ii) as in effect prior to GATT was renumbered as section 415(b)(2)(E)(iii). The new section 415(b)(2)(E)(ii) under GATT provides that, for purposes of adjusting the benefit or limitation of any form of benefit subject to section 417(e)(3), the applicable interest rate (as defined in section 417(e)(3)) is substituted for "5 percent" in clause (i). Section 415(b)(2)(E)(v), added by GATT, provides that, for purposes of adjusting any benefit or limitation under section 415(b)(2)(B), (C), or (D), the mortality table prescribed by the Secretary must be used.

Thus, under the GATT provisions, for purposes of testing a benefit subject to section 417(e)(3) for satisfaction of section 415(b), adjustments of the benefit and limitation must be performed taking the applicable interest rate into account. The applicable mortality table must be taken into account for all adjustments under sections 415(b)(2)(B), (C), and (D).

Section 417(e)(3) provides rules regarding the actuarial assumptions to be used to determine the present value of a participant's accrued benefit. GATT amended section 417(e)(3) to provide a specific mortality table and changed "the applicable interest rate" that must be used to determine the present value of a benefit subject to section 417(e)(3). The applicable interest rate specified in section 417(e)(3) is the annual interest rate on 30-year Treasury securities as specified by the Commissioner. Benefits subject to section 417(e)(3) include all forms of benefit except benefits payable in the form of an annual benefit that does not decrease during the life of the participant, or, in the case of a QPSA, the life of the participant's spouse; or decreases during the life of the participant merely because of the death of the survivor annuitant (but only if the reduction is to a level not below 50 percent of the annual benefit payable before the death of the survivor annuitant), or the cessation or reduction of Social Security supplements or qualified disability payments (as defined in section

411(a)(9)). (See section 417(e)(3) and the regulations thereunder to determine whether a form of benefit is subject to section 417(e)(3).)

The mortality table to be generally used for purposes of section 415(b)(2)(E)(v) ("the applicable mortality table") was published in Rev. Rul. 95-6, 1995-1 C.B. 80. Generally, this table must be used to determine actuarial equivalence for purposes of section 415(b). Rev. Rul 95-6 is included at the end of this chapter.

The GATT amendments to section 415(b)(2)(E) were generally effective as of the first day of the first limitation year beginning in 1995, although an employer could elect to treat the changes as being effective on or after December 8, 1994. This effective date applies regardless of when the plan is amended to reflect changes made to section 417(e)(3) by GATT. GATT further provided that a plan that operates in accordance with the section 415(b)(2)(E) changes will not be treated as failing to satisfy section 401(a) merely because it has not been amended to reflect the section 415(b)(2)(E) changes.

GATT also provided that a participant's accrued benefit would not be considered to be reduced in violation of section 411(d)(6) where such reduction results solely from the application of the section 415(b)(2)(E) changes. Although a participant's accrued benefit is permitted to be reduced, section 767(d)(3) of GATT provided that an accrued benefit is not required to be reduced below the accrued benefit as of the last day of the last plan year beginning before January 1, 1995. Thus, an employee's accrued benefit as of the last day of the last plan year beginning before 1995 could be (but was not required to be) protected. (See section 767(d) of GATT.)

Rev. Rul. 95-29, 1995-1 C.B. 81, provided guidance in the form of questions and answers on the limitations on benefits and contributions under section 415 as amended by GATT. Rev. Rul. 95-29 is included at the end of this chapter.

SBJPA Modifies GATT Changes to Section 415(b)(2)(E).

SBJPA (section 1449(b)) amended section 415(b)(2)(E)(i) to provide that for purposes of adjusting any limitation under 415(b)(2)(C) and, except as provided in clause (ii), for purposes of adjusting any benefit under 415(b)(2)(B), the interest rate assumption must not be less than the greater of 5 percent or the rate specified in the plan. SBJPA also amended section 415(b)(2)(E)(ii) to delete the reference to adjusting a limitation in that section. As amended, section 415(b)(2)(E)(ii) provides that for purposes of adjusting any benefit under 415(b)(2)(B) for any form of benefit subject to section 417(e)(3), the applicable interest rate (as defined in section 417(e)(3)) is substituted for "5 percent" in clause (i).

Thus, for purposes of determining whether a form of benefit subject to section 417(e)(3) satisfies the limitations of section 415, the applicable interest rate is substituted for 5 percent solely for purposes of adjusting the **benefit** (and not for purposes of adjusting the section 415(b) **dollar limitation**). SBJPA did not change the rules relating to the application of the new mortality table under section 415(b)(2)(E)(v).

The following example explains the steps generally taken to apply the section 415 limitations where a benefit commences at SSRA.

EXAMPLE (9):

a. Under SBJPA, how is a benefit that is not in the form of a straight life annuity, commencing at a participant's social security retirement age (SSRA), and that **is not subject to section 417(e)(3)**, tested for satisfaction of the section 415 limitations?

SOLUTION:

Step 1. For purposes of applying the limitations of section 415, the benefit would be converted to an actuarially equivalent benefit in the form of a straight life annuity ("annual benefit") commencing at the same age. In general, sections 415(b)(2)(E)(i) and (v) (and Rev. Rul. 98-1) require that the equivalent annual benefit be the **greater** of (1) the equivalent annual benefit computed using the interest rate and mortality table (or plan tabular factor) specified in the plan for actuarial equivalence for the particular form of benefit payable; and (2) the equivalent annual benefit computed using a 5 percent interest rate assumption and the applicable mortality table.

Step 2. Determine the lesser of the currently effective dollar limitation or 100 percent of the participant's high three-year average compensation (each adjusted where required under section 415(b)(5)).

Step 3. Compare the benefit, when expressed in the form of an equivalent straight life annuity (annual benefit) commencing at the same age to the applicable limitation at that age under section 415(b). If the equivalent annual benefit exceeds the limitation, it must be limited so that it does not exceed the limitation.

b. How would the testing above change if the benefit described in part (a) **is subject to section 417(e)(3)**?

SOLUTION:

The same steps would be taken for purposes of section 415 testing except that in determining the equivalent annual benefit the applicable interest rate is substituted for the 5 percent interest rate. That is, the equivalent straight life annuity in step 1 above is the **greater** of:

(1) the equivalent annual benefit computed using the interest rate and mortality table (or plan tabular factor) specified in the plan for actuarial equivalence for the particular form of benefit payable; and

(2) the equivalent annual benefit computed using the applicable interest rate and the applicable mortality table.

c. How would the testing above change if the benefit was payable as a straight life annuity?

SOLUTION:

Step 1 would not be necessary. The straight life annuity would be compared to the applicable limitation from step 2, and limited as required under step 3.

d. How would the testing above change if the benefit in parts (a), (b), or (c) is payable at an age other than the participant's SSRA?

SOLUTION:

The same general steps are followed except that, where the benefit is payable at a commencement age other than SSRA, an age-adjusted dollar limitation is used in step 2. The age-adjusted dollar limit is the annual benefit payable at the commencement age which is equivalent to the dollar limit at SSRA, calculated using assumptions which satisfy section 415(b)(2)(E). See the later section "Adjustments For Commencement Of Benefits Before And After Social Security Retirement Age" for examples on how such age-adjusted limitations are calculated.

SBJPA section 1449(a) amended section 767(d)(3) of GATT to

provide that plans adopted and in effect before December 8, 1994, **are not required** to apply the section 415(b)(2)(E) changes (as amended by SBJPA) with respect to benefits accrued before the earlier of (i) the date a plan amendment applying the section 415(b)(2)(E) changes is adopted or made effective, whichever is later, or (ii) the first day of the first limitation year beginning after December 31, 1999. Determinations under section 415(b)(2)(E) before such earlier date shall be made with respect to such benefits on the basis of section 415(b)(2)(E) and the provisions of the plan as in effect on December 7, 1994 (but only if such provisions of the plan meet the requirements of section 415 as in effect on December 7, 1994).

(Note that section 1449(a) of SBJPA was modified by TRA '97 to delete the parenthetical clause "(except that the modification made by section 1449(b) of the Small Business Job Protection Act of 1996 shall be taken into account)."

Thus, while section 767(d)(3) of GATT as originally enacted provides that accrued benefits as of the last day of the last plan year beginning before 1995 could be (but are not required to be) protected, SBJPA amended section 767(d)(3) to provide that accrued benefits could be (but are not required to be) protected as of a date that is as late as the last day of the last limitation year beginning before January 1, 2000, depending on when the amendment applying the section 415(b)(2)(E) changes is adopted and made effective.

Section 1449(c) of SBJPA provides that the amendments made by sections 1449(a) and (b) are effective as if included in the provisions of section 767 of GATT.

Section 1449(d) of SBJPA provides a transitional rule for sponsors of plans adopted and in effect before December 8, 1994, who adopted or made effective on or before the enactment date of SBJPA (August 20, 1996) an amendment applying the amendments made by section 767 of GATT (the section 415(b)(2)(E) changes). If, within one year of the enactment of SBJPA, an amendment made to conform the plan to the requirements of section 767 of GATT is repealed, the original amendment is not taken into account for purposes of applying section 1449(a) of SBJPA. Section 7 of Rev. Proc. 97-41, 1997-33 I.R.B. 51, provides that an original amendment is not taken into account in applying section 767(d)(3)(A) of GATT as revised by

section 1449(a) of SBJPA if a repealing amendment is adopted on or before the last day of the plan's remedial amendment period under section 401(b) for disqualifying provisions under SBJPA and GATT. Thus, an employer adopting a repealing amendment to a plan has the same options for that plan as an employer that has not made any plan amendments to apply the section 415(b)(2)(E) changes.

Rev. Rul. 98-1, 1998-2 I.R.B. 5 provides guidance in the form of questions and answers on the limitations on benefits and contributions under section 415 as amended by GATT and taking into account the applicable provisions of SBJPA, after technical correction made by the Taxpayer Relief Act of 1997 (TRA '97). **This revenue ruling modifies and supersedes Rev. Rul. 95-29.**

Rev. Rul. 98-1 provides guidance on the SBJPA transition rules regarding the application of the section 415(b)(2)(E) changes. These rules and others are discussed in a later section, "Rev. Rul. 98-1 Provides Guidance And Transition Rules After SBJPA ". Rev. Rul. 98-1 is included at the end of this chapter.

Adjustments For Other Forms Of Benefit

Where a DB plan provides a retirement benefit in any form **other than a straight life annuity**, for purposes of applying the section 415(b) limitations to a participant's annual benefit, the participant's plan benefit (except for those benefits discussed below for which no adjustment is required) is adjusted to a straight life annuity beginning at the same age which is the actuarial equivalent of such benefit. (See section 415(b)(2)(B) and Reg. section 1.415-3(c).)

Qualified Joint and Survivor Annuity.

No adjustment is required for a benefit payable as a qualified joint and survivor annuity to the extent that the value of such annuity exceeds the sum of (A) the value of a straight life annuity beginning on the same date and (B) the value of any post-retirement death benefits which would be payable even if the annuity was not in the form of a joint and survivor annuity.

EXAMPLE (10):

A DB plan (Plan A) provides for an annual benefit of 100% of final average compensation, not to exceed the lesser of the section 415(b) dollar or compensation limitations. A participant of Plan A, Mrs. Jones, retires in 1996 and has her benefit limited by section 415(b)(1) to $120,000. This participant is married at the time benefits commence at her social security retirement age (SSRA), and the plan will pay an annuity of 100% of compensation (up to $120,000) during her lifetime, and should she die, a qualified survivor annuity of the same amount will be provided during her spouse's lifetime. This plan formula would meet the IRC section 415(b) limits because the spouse's benefit is not considered an additional benefit for section 415 purposes, since it is a qualified joint and survivor annuity.

(If, however, the plan included a 10-year certain feature providing that 100% of compensation was payable during the participant's lifetime and her spouse's lifetime, should she die--but in no event, for a period shorter than 10 years--the formula would not satisfy section 415(b). The 10-year certain feature would make this benefit more valuable than a simple joint and survivor annuity, and the full dollar limitation of $120,000 could not be provided.)

Note: Where a plan provides that the normal form of benefit distribution is a straight life annuity with married participants automatically receiving the benefit as a subsidized qualified joint and survivor annuity, and also provides for elective single-sum distributions, the maximum single sum which could be distributed to any married participant who elects a single sum is the actuarial equivalent of the maximum allowable straight life annuity, not the actuarial equivalent of the maximum allowable joint and survivor annuity. The increased benefit provided by a joint and survivor annuity for which no adjustments are made is available only if such benefit is paid as a joint and survivor annuity. All other forms of benefit are limited to the actuarial equivalent of the maximum allowable straight life annuity benefit.

Where a plan provides that the amount of a participant's benefit to be paid in the form of a joint and survivor annuity is calculated by applying a reduction

factor to the participant's single life annuity benefit under the plan formula, the terms of the plan may provide that the reduction factor is applied before the section 415 limit is applied.

EXAMPLE (11):

Mr. Jones, after 25 years of participation in a defined benefit plan, Plan Z, will retire and commence receiving benefits in 1997 at his social security retirement age of 65. Under Plan Z, Mr. Jones' benefit, paid as a single life annuity, is $150,000 before the application of section 415(b). If Mr. Jones' benefit is paid as a joint and 50% survivor annuity, the plan provides that an 85% reduction factor is applied to the single life annuity benefit, before limitation for section 415(b). The plan further provides that the survivor portion of a participant's benefit, when in the form of a joint and 50% survivor annuity, is computed using the participant's benefit, reduced for the joint and survivor form, but prior to the application of section 415(b), provided that the survivor portion does not exceed the benefit payable to Mr. Jones, after limitation for section 415(b).

Mr. Jones' benefit in the form of a joint and 50% survivor annuity would be calculated as $127,500 ($150,000 x 85% = $127,500), which would then be limited by section 415(b) to a $125,000 joint and 50% survivor annuity. The survivor portion of the annuity will be computed as 50% of $127,500, or $63,750.

Note: Of course, under the top-heavy rules this is a nonproportional subsidy (unless the group to which the subsidy applies would independently satisfy the requirements of section 410(b)). See the top-heavy rules or the examination guidelines on top-heavy plans.

Post-Retirement COLAs

No adjustment is required for the value of benefits which reflect post-retirement cost-of-living increases if these are made in accordance with the regulations.

(Note, however, that should the terms of the plan provide for such post-retirement cost-of-living increases, for purposes of determining whether the dollar limitation has been exceeded, the present value of such benefits could not exceed the present value of the maximum benefit payable under section 415(b), with both present values calculated for commencement at the same age.)

Ancillary Benefits

IRC section 415(b)(2)(B) provides that any ancillary benefit which is not directly related to retirement income benefits (such as pre-retirement disability and death benefits and post-retirement medical benefits) is not taken into account when adjusting the plan benefit for other forms of benefit for purposes of demonstrating satisfaction of the DB plan limitations. (See also Reg. section 1.415-3(b)(2).)

The following two examples illustrate section 415(b) testing where participant's benefits must be adjusted for form.

EXAMPLE (12):

Plan A, a DB plan, provides that single-sum distributions are determined as the actuarial present value of the annual straight life annuity payable at the actual retirement date. Prior to GATT, Plan A provides that a single sum is determined using the 83 IAM (Male) Mortality Table and 6% interest, but must be at least as great as the single sum calculated using the §417(e) interest rates. The 83 IAM (Male) table is also used for purposes of section 415(b) adjustments under the Plan.

Following GATT as amended by SBJPA, Plan A is amended to provide that a single sum is determined as the greater of the single sums determined using (1) 83 IAM (Male) and 6%, and (2) the applicable interest rate and the applicable mortality table. The Plan has been amended to apply the §415(b)(2)(E) changes to all accrued benefits for all participants under the Plan. The applicable interest rate is 8%.

Participant M, whose SSRA is age 65, retires at age 65 from Plan A and elects to receive a distribution in the form of a single sum. Both before and after GATT, the largest single sum is equal to $950,000 (the $950,000 single sum determined using the 83 IAM Mortality Table and 6% interest exceeded the single sums determined using the other stated assumptions to be taken into account in determining single sums).

QUESTION: How are the IRC 415(b) limitations applied to M's benefit?

SOLUTION PRIOR TO GATT:

Step 1: the $950,000 is converted to a straight life annuity by dividing it by an age 65 annuity factor, determined using the 83 IAM Table and 6% (the greater of 5% and the plan's rate), as shown below.

$950,000 / 10.576 = $89,826

Step 2: the applicable §415(b) limitation, the lesser of the dollar limitation and the compensation limitation applicable to M's benefit, is determined.

Step 3: M's equivalent annual benefit ($89,828) must not exceed the applicable limitation. Limit as necessary.

SOLUTION AFTER GATT AS AMENDED BY SBJPA:

Step 1: Convert the $950,00 to an equivalent straight life annuity.

(i) based on the plan definition of actuarial equivalence for single sums, the $950,000 is divided by an immediate annuity purchase rate using 83 IAM and 6%:

$950,000 / 10.576 = $89,826

(ii) the $950,000 is divided by an annuity factor derived using the applicable interest rate (8%) and the applicable mortality table:

$950,000 / 9.196 = $103,306

The equivalent annual benefit for purposes of §415 is the greater of (i) and (ii), which is $103,306.

Step 2: Determine the applicable §415(b) limit, the lesser of the applicable dollar limitation and the applicable compensation limitation.

Step 3: The equivalent annual benefit ($103,306) must not exceed the applicable limit. Limit as needed.

EXAMPLE (13):

Plan R, a DB plan, provides that the normal form of pension is a 10-year certain and life annuity. Actuarial equivalence for all purposes under the Plan is based on the 83 IAM (Male) Mortality Table and 6% interest. Following SBJPA, the Plan was amended to apply the §415(b)(2)(E) changes to all accrued benefits for all participants under the Plan.

Participant P, whose SSRA is age 65, retires at age 65 from Plan A and elects to receive the plan benefit equal to a $120,000 per year 10-year certain and life annuity.

How are the IRC 415(b) limitations applied to P's benefit?

SOLUTION PRIOR TO GATT:

Step 1: the 10-year certain and life annuity is converted to an equivalent straight life annuity commencing at the same age using the 83 IAM table and 6% (the greater of the plan rate and 5%). This is accomplished by converting the 10-year certain and life annuity to a lump sum by multiplying $120,000 by the annuity purchase rate for an age 65 10-year certain and life annuity, and then converting the lump sum to a straight life annuity by dividing it by the purchase rate for an age 65 straight life annuity.

($120,000 x 11.132) / 10.576 = $126,309

The equivalent annual benefit payable at age 65 as a straight life annuity is equal to $126,309.

Step 2: Determine the applicable §415(b) limit, the lesser of the applicable dollar limit or the applicable compensation limit.

Step 3: The equivalent annual benefit must not exceed the applicable limitation. Limit as necessary.

SOLUTION AFTER GATT AS AMENDED BY SBJPA:

Step 1: Convert the 10-year certain and life annuity to a straight life annuity. (Note that this benefit is a nondecreasing annuity benefit and is not subject to §417(e)(3).)

(i) Using the plan's definition of actuarial equivalence, the $120,000 10-year certain and life benefit is converted to an equivalent straight life annuity, using annuity factors (based on 83 IAM and 6%) for an age 65 10-year certain and life annuity and an age 65 straight life annuity.

($120,000 x 11.132) / 10.576 = $126,309

(ii) Using 5% interest and the applicable mortality table, the 10-year certain and life benefit is converted to a straight life annuity. The applicable annuity factors are 12.079 (annuity factor for an age 65 10-year certain and life annuity) and 11.534 (age 65 straight life annuity factor).

($120,000 x 12.079) / 11.534 = $125,670

The equivalent annual benefit payable as a straight life annuity is equal to the greater benefit, $126,309.

Step 2: Determine the applicable §415(b) limit.

Step 3: The equivalent annual benefit must not exceed the applicable limitation. Limit as needed.

Adjustments For Commencement Of Benefits Before And After Social Security Retirement Age

The Tax Reform Act of 1986 (TRA '86) tied adjustments to the section 415(b) DB dollar limitation for early or late commencement of benefits to the social security retirement age (SSRA), rather than to age 65 (and ages 62 and 55) as in effect under prior law. Prior to TRA '86, early retirement adjustments were applicable only for ages under 62, and no adjustment was required for retirement between ages 62 and 65. These adjustments are further explained in Notice 87-21, 1987-1 C.B. 458. No adjustment is made to the high three-year average compensation limitation for early (or late) retirement.

Adjustment Of The DB Dollar Limitation Where Benefits Commence Before A Participant's Social Security Retirement Age (SSRA).

If retirement income benefits under a plan commence before a participant's SSRA, the determination as to whether the limitation has been satisfied is

made by reducing the dollar limitation so that such reduced limitation (beginning when such retirement income benefit begins) is equivalent to a $90,000 annual benefit beginning at the applicable SSRA. The $90,000 amount is, of course, adjusted as applicable under section 415(d).

Social Security Retirement Age (SSRA).

According to the rules found in Notice 87-21, social security retirement age can be defined as follows:

65 for a participant born before 1/1/38 ;

66 for a participant born after 12/31/37 and before 1/1/55

67 for a participant born after 12/31/54.

Commencement Of Benefits Before SSRA, But On Or After Age 62.

The limitation for benefits which commence before SSRA, but on or after age 62 is computed using the following reduction factors:

(a.) If a participant's SSRA is 65, the DB dollar limitation for benefits commencing on or after age 62 is reduced by 5/9 of 1% for each month by which benefits commence before the month in which the participant attains age 65.

(b.) If a participant's SSRA is greater than 65, the DB dollar limitation for benefits commencing on or after age 62 is reduced by 5/9 of 1% for each of the first 36 months and by 5/12 of 1% for each additional month (up to 24 months) by which benefits commence before the month of the participant's SSRA.

EXAMPLE (14):

Participant A's SSRA is 65 and A will commence receiving benefits under the plan immediately following the attainment of age 63. If the current dollar limitation under section 415(b)(1)(A) is $120,000, what limitation will be applied to A at age 63?

SOLUTION:

The benefit would commence 24 months before A's SSRA, and the reduction in the limitation will be done as follows.

120,000-(120,000)[(5/9)x(.01)x(24)]
= 120,000 - 16,000
= 104,000

The equation could also be written as follows.

120,000 x [1-{(5/9)x(.01)x(24)}]
= 120,000 x [1-(2/15)]
= 120,000 x [13/15]
= 104,000

EXAMPLE (15):

Participant B has a SSRA of 66 and the plan NRA is 62. If the current section 415(b)(1)(A) dollar limitation is $90,000, what dollar limitation is applicable to B for commencement of benefits at age 62?

SOLUTION:

At age 62, B's benefit would commence 48 months before B's SSRA. The reduction in the dollar limitation is as follows:

90,000 - (90,000)[(5/9)x(.01)x(36)
+ (5/12)(.01)(12)]
= 90,000 - (90,000)(25%)
= 90,000 - 22,500
= 67,500

Commencement Of Benefits Before Age 62.

If a participant's benefits commence before the participant attains age 62, the DB dollar limitation (as reduced above) shall be further reduced for each month by which benefits commence before the month in which the participant attains age 62, so that the dollar limitation will be the actuarial equivalent of the dollar limitation determined at age 62.

The interest and mortality assumptions used for purposes of adjusting the dollar limitation where benefits commence before the participant attains age 62 must satisfy the requirements of section 415(b)(2)(E).

Prior to GATT

This section required that where benefits commence prior to age 62, the dollar limitation is adjusted to an amount payable at the earlier age which is equivalent to the age 62 limitation, using the greater of the plan rate (for early retirement) and 5

percent. (The use of a lesser interest rate could result in a greater limitation.) The plan mortality table (used for early retirement) is generally used to take mortality into account for this purpose, but another reasonable mortality table as specified under the plan could be used.

After GATT and prior to enactment of SBJPA

The actuarial assumptions which must be taken into account for purposes of adjusting the dollar limitation for early commencement of benefits were dependent on whether the form of benefit being tested was a form subject to section 417(e)(3).

Where a benefit is not in a form subject to section 417(e)(3) and commences prior to age 62, sections 415(b)(2)(E)(i) and (v) provide that the dollar limitation at the earlier age is the **lesser** of:

(1) the amount equivalent to the age 62 limitation, computed using the interest rate and mortality table (or other tabular factor) used for actuarial equivalence for early retirement benefits under the plan; and

(2) the amount equivalent to the age 62 limitation, computed using 5 percent interest and the applicable mortality table.

Where the benefit is in a form subject to section 417(e)(3) and commences prior to age 62, sections 415(b)(2)(E)(ii) and (v) provide that the dollar limitation at the earlier age is the **lesser** of:

(1) the amount equivalent to the age 62 limitation, computed using the interest rate and mortality table (or other tabular factor) used for actuarial equivalence for early retirement benefits under the plan; and

(2) the amount equivalent to the age 62 limitation, computed using the applicable interest rate and the applicable mortality table.

(Note that since SBJPA amended GATT retroactively, plans ordinarily

would not follow the rules in this subsection for distributions made after the enactment of GATT and prior to August 20, 1996. However, in accordance with Q&A-11 of Rev. Rul. 98-1, distributions during that period need not be redetermined to follow the SBJPA modifications.)

After GATT as amended by SBJPA

Where the age at which the benefit is payable is less than 62, the dollar limit at the earlier age is equal to the **lesser** of: (1) the equivalent amount computed using the plan rate and plan mortality table (or plan tabular factor) used for actuarial equivalence for early retirement benefits under the plan; and (2) the amount computed using 5 percent interest and the applicable mortality table. **This is the case whether or not the benefit is in a form subject to section 417(e)(3).**

In determining actuarial equivalence for this purpose, it is generally necessary to take mortality into account. However, the mortality decrement may be ignored to the extent that a forfeiture does not occur at death. In other words, the limitation may be reduced using interest only solely in the case where there is no forfeiture at death. This would be true where the death benefit is the present value of accrued benefits (PVAB), but not necessarily where the only pre-retirement death benefit is a qualified pre-retirement survivor annuity (QPSA). (See IRC section 415(b)(2)(E), Q&A-5 of Notice 87-21, and Q&A G-3 of Notice 83-10.)

EXAMPLE (16):

Plan X, a DB plan, provides that early retirement annuity benefits are the actuarial equivalent of the normal form of annuity payable at age 65. Actuarial equivalence is determined for all purposes under the Plan using the 83 IAM (Male) Table and 6% interest. The Plan provides that there is no forfeiture of retirement benefits on death.

M, a participant of Plan X, retires in 1998 at age 60 with a benefit (prior to the application of section 415) of $95,000 payable at age 60 as a straight life annuity. M has more than 10 years of participation service. The dollar limit at SSRA is $130,000, and M's SSRA is 66.

What is the dollar limitation that is applicable to M's benefit?

a. If the plan has been amended not to apply the section 415(b)(2)(E) changes under GATT and SBJPA to M's benefit and the amendment is permitted under the rules of Rev. Rul. 98-1:

(i) the dollar limit is adjusted from age 66 (SSRA) to age 62 as follows.

$$130{,}000 \times [1 - (5/9)(.01)(36) - (5/12)(.01)(12)] = 130{,}000 \times [.75] = 97{,}500$$

(ii) the dollar limit at age 60 is calculated using the 1983 IAM (Male) Mortality Table and 6% (the greater of the plan rate and 5%). (Because there is no forfeiture of benefits on death, the age 62 single sum is taken to age 60 using interest only.)

$$\$97{,}500 \times \frac{N_{62}^{(12)} \times \frac{1}{D_{62}\ (1.06)^2}}{\frac{N_{60}^{(12)}}{D_{60}}}$$

$$= \frac{97{,}500 \times 11.319 \times .8900}{11.778}$$

= 83,393

The dollar limit at age 60 is $83,393. (M's benefit exceeds this limitation and must be limited.)

b. If the plan has been amended to apply the section 415(b)(2)(E) changes under GATT and SBJPA to all accrued benefits for all participants under the plan:

(i) the dollar limit is adjusted from age 66 to age 62 in the same manner as above, yielding an age 62 limit of $97,500.

(ii) the age 62 dollar limit is adjusted to age 60 applying the same methodology/formula as shown in (a) above, but using the plan 's basis for actuarial equivalence (6% and 83 IAM).

[97,500 x 11.319 x .8900] / 11.778 = 83,393

(iii) the age 62 dollar limit is adjusted to age 60 applying the same formula as shown in (a) above, using 5% interest and the applicable mortality table.

$[97,500 \times 12.456 \times \{1 / (1.05)^2\}] / 13.037$
$= [97,500 \times 12.456 \times .90703] / 13.037$
$= 84,494$

The dollar limit at age 60 is the lesser of the amounts in (ii) and (iii), or $83,393. (M's benefit at age 60 ($95,000) exceeds this limitation and must be limited to $83,393.)

EXAMPLE (17):

Plan Z, a DB plan, provides that single-sum distributions are determined as the actuarial present value of the annual straight life annuity payable at the actual retirement date. Plan Z provides that a single sum is determined using the Plan factors for determining actuarial equivalence, 83 IAM (Male) Mortality Table and 6%. In accordance with section 417(e) and the regulations thereunder, the plan further provides that any single-sum distribution must be at least as great as the actuarial present value of the participant's accrued normal retirement annuity benefit, computed in accordance with the requirements of that section. Additionally, any single sum must not be less than the present value of the annuity at the actual retirement date, derived using the section 417(e)(3) rates.

Participant C, whose social security retirement age is age 66, retires in 1998 at age 60 with a single sum benefit of $950,000 (the single sum derived using 83 IAM and 6% exceeded the single sums derived using the section 417(e)(3) rates). Participant C has more than 10 years of participation at his retirement date. C's high three-year average compensation is equal to $150,000. The applicable interest rate is 8%.

How are the section 415(b) limitations applied to C's benefit?

a. If the plan has been amended not to apply the section 415(b)(2)(E) changes under GATT (as amended by SBJPA) to C's benefit and the amendment is permitted under the rules of Rev. Rul 98-1:

Step 1. Calculate the equivalent annual benefit as a straight life annuity payable at age 60, by dividing the single sum by an age 60 annuity factor (11.778), derived using the 83 IAM table and 6% interest (the greater of the plan rate and 5%) .

950,000 / 11.778 = 80,659

Step 2. Determine the applicable section 415(b) limitation. The dollar limit applicable to C's benefit at age 60 is derived using the same steps as those used in part (a) of example 16, and is equal to $83,393. The age 60 dollar limit is less than the compensation limit applicable to C ($150,000), so the dollar limit is the applicable limitation.

Step 3. The equivalent annual benefit payable at age 60 ($80,659) does not exceed the section 415(b) limit applicable to C at age 60 (83,393). Thus, C's single sum benefit satisfies section 415(b).

b. If the plan has been amended to apply the section 415(b)(2)(E) changes to all accrued benefits for all participants under the Plan:

Step 1. Calculate the equivalent annual benefit as a straight life annuity payable at age 60.

(i) The single sum is converted to a straight life annuity payable at age 60 by dividing it by an age 60 annuity purchase rate (annuity factor) derived **using the plan factors** of 6% and 83 IAM (11.778).

950,000 / 11.778 = 80,659

(ii) Because the single sum is a benefit subject to section 417(e)(3), the single sum is converted to a straight life annuity payable at age 60 by dividing it by an age 60 annuity purchase rate (10.098) derived **using the applicable interest rate (8%) and the applicable mortality table**.

950,000 / 10.098 = 94,078

(iii) The equivalent annual benefit is equal to the greater of the amounts, $94,078.

Step 2. The age 60 dollar limit applies because it is less than the compensation applicable to C's benefit. The age 60 dollar limit is calculated as shown in part b of example 16, and is equal to $83,393.

Step 3. C's age 60 single sum benefit (950,000), when expressed as an equivalent annual benefit commencing at age 60 (94,078), exceeds the section 415(b) limit applicable to C's benefit at age 60 (83,393). Therefore, C's single-sum benefit must be limited to $842,103, calculated as shown below.

83,393 x 10.098 = 842,103

Employee Plans CPE Technical Topics for 1998

EXAMPLE (18):

Plan S, a defined benefit plan, provides for single-sum distributions of a participant's benefit as the normal form of benefit and specifies that an 8% interest rate and the UP-1984 Mortality Table are to be used for determining actuarial equivalence for other forms of benefit. Under Plan S, the interest assumption of 6% is used with the UP-1984 Mortality Table for purposes of calculating early retirement benefits. Normal retirement age under Plan S is age 63.

Because there is some forfeiture on death under Plan S, the plan provides that actuarial equivalence is calculated using the full mortality adjustment (rather than calculating actuarial equivalence using a mortality adjustment to the extent that a forfeiture occurs on death).

Part 1

Mr. North, a participant in Plan S for 15 years, will retire in 1994 at age 60 with a single-sum benefit under the plan of $550,000. Mr. North's SSRA is 65. How is the section 415(b) dollar limitation applied to Mr. North's benefit?

SOLUTION:

Step 1: the $550,000 is converted to an actuarially equivalent straight life annuity commencing at age 60. The UP-1984 table and 8% (the greater of the plan rate used for other forms of benefit and 5%) are used to generate a $1 per year age 60 annuity factor of 9.133 ($N_{60}^{(12)}/D_{60}$). The single sum, divided by 9.133, converts to a straight life annuity commencing at age 60 of $60,221 ($550,000/9.133).

Step 2: Mr. North's high three average compensation exceeds the dollar limitation, so the dollar limitation applies. The section 415(b) dollar limitation, adjusted for early commencement at age 60, must be determined. The limitation is first reduced to the limitation for a benefit commencing at age 62, using the reduction factors of Q&A-5 of Notice 87-21. Using these factors, the 1994 limitation is reduced for commencement at age 62, 36 months earlier than the participant's social security retirement age of 65.

$118,800 x [1-(5/9)(.01)(36)]
= $118,800 x .80
= $95,040

The limitation for age 62 (for a participant with a SSRA of 65) is further reduced for commencement of benefits at age 60, using the UP-1984 table and an interest assumption of 6% (the greater of the plan rate used for early retirement and 5%).

$$\$95{,}040 \times \frac{\dfrac{N^{(12)}_{62}}{D_{62}} \times \dfrac{D_{62}}{D_{60}}}{\dfrac{N^{(12)}_{60}}{D_{60}}}$$

$$= [\$95{,}040 \times 10.105 \times 0.86379]/10.596$$
$$= \$78{,}290$$

Step 3: The benefit to be distributed to Mr. North in 1994 (when expressed as a straight life annuity of $60,221 commencing at the same age) does not exceed the section 415(b) dollar limitation applicable to Mr. North at that age ($78,290).

Part 2

Assume in the example above that, rather than retiring at age 60, Mr. North retires in 1997 at age 63 with a single-sum benefit of $850,000. The plan has been amended to apply the section 415(b)(2)(E) changes under GATT (as amended by SBJPA) to all accrued benefits under the Plan. The applicable rate is 7 percent. How is the section 415(b) dollar limitation applied to Mr. North's benefit?

Step 1: The annual benefit equivalent to the single-sum benefit must be determined.

(i) The equivalent annual benefit is determined using the plan factors of 8% and UP-1984 to determine an age 63 annuity factor of 8.582.

850,000 / 8.582 = 99,045

(ii) The equivalent annual benefit is determined using the applicable interest rate (7%) and the applicable mortality table to determine an age 63 annuity factor of 10.319.

850,000 / 10.319 = 82,372

The equivalent annual benefit used for section 415(b) testing is the greater of these two benefits, $99,045.

Step 2: The section 415(b) limitation applicable at age 63 must be determined. Mr. North's high three average compensation still exceeds the dollar limitation, so the dollar limitation applies. The 1997 dollar limit applicable at Mr. North's SSRA (65) must be adjusted to age 63 using the factors from Notice 87-21.

125,000 x {1-[(5/9)(.01)(24)]}
= 125,000 x {13/15}
= 108,333

Step 3: The annual benefit at age 63 equivalent to Mr. North's single-sum benefit at age 63 (99,045) does not exceed the dollar limitation applicable to Mr. North at age 63 (108,333).

Adjustment Of The DB Dollar Limitation Where Benefits Commence After A

Participant's SSRA.

If the retirement income benefit under a plan commences after a participant's SSRA, the determination as to whether the dollar limitation has been satisfied is made by increasing the limitation so that such limitation (as so increased) equals an annual benefit (beginning when such retirement income benefit begins) which is equivalent to the dollar limitation expressed as an annual benefit beginning at the participant's SSRA. However, the benefit payable must not exceed 100% of the participant's high three-year average compensation. No adjustment is made to the high three-year compensation limitation for late retirement.

The interest and mortality assumptions used for purposes of adjusting the dollar limitation where benefits commence after a participant's SSRA must satisfy the requirements of section 415(b)(2)(E).

Prior to GATT

This section provided that for purposes of adjusting the dollar limitation for benefits commencing after the social security retirement age, the interest rate assumption shall not be greater than the lesser of 5% or the rate specified in the plan. (The use of a greater rate could result in a greater limitation.)

Although in determining actuarial equivalence for these purposes, a reasonable mortality table may be used to the extent that a forfeiture can occur on death between normal retirement age and the commencement of benefits, the accumulation of value after social security retirement age but prior to the actual commencement of benefits must not reflect the mortality decrement to the extent that benefits are not forfeited if the participant dies between the social security retirement age and the date benefits actually commence. (See IRC section 415(b)(2) and Q&A G-4 of Notice 83-10.)

Under GATT, as amended by SBJPA

The increased age-adjusted dollar limit is the lesser of the equivalent amount computed using the plan rate and plan mortality table (or plan tabular factor) used for actuarial equivalence for late retirement benefits under the plan and the equivalent amount computed using 5

percent interest and the applicable mortality table, to the extent mortality is taken into account as described in the prior paragraph.

EXAMPLE (19):

Mr. Ellis was eligible to retire under Plan P at his SSRA and NRA of 65 in 1996, but chose to continue working. He retired in 1998 at age 67, with a high three-year average compensation of $175,000 and an accrued benefit before application of section 415(b) of $152,000 per year. The terms of the defined benefit plan provide that the UP-1984 Mortality Table and 6% are used for determining actuarial equivalence for retirement after age 65. Under Plan P, there is no forfeiture of Mr. Ellis' accrued benefit should he die after age 65, but before actual retirement. What is the section 415(b) limitation applicable to Mr. Ellis?

SOLUTION:

a. If the Plan has been amended not to apply the section 415(b)(2)(E) changes under GATT (as amended by SBJPA) to Mr. Ellis' benefit, and the amendment is permitted under the rules of Rev. Rul. 98-1:

Here, there is no forfeiture on death. Therefore, the dollar limitation applicable to Mr. Ellis in 1998 must be calculated without taking mortality into account for the two years. The following calculations determine the DB dollar limitation for retirement 2 years after Mr. Ellis' SSRA, at age 67, using UP-1984 and 5 percent (the lesser of the plan rate and 5 percent).

$$\$130{,}000 \times \frac{\frac{N^{(12)}_{65}}{D_{65}} \times (1.05)^2}{\frac{N^{(12)}_{67}}{D_{67}}}$$

$$= \frac{\$130{,}000 \times 10.036 \times 1.1025}{9.447}$$

$$= \frac{\$1{,}438{,}410}{9.447}$$

$$= \$152{,}261$$

As shown above: the 1998 DB dollar limitation (expressed as an annual benefit) is

converted into a single sum at age 65 by multiplying it by an age 65 annuity factor (determined using the UP-1984 Mortality Table and 5% (the lesser of the plan rate or 5%)); the age 65 single sum is then advanced to age 67 using interest only: and the resulting single sum is converted back into an annual benefit at age 67 when divided by an age 67 annuity factor (again determined using the UP-1984 Mortality Table and 5%).

The dollar limitation (152,261) is less than Mr. Ellis' high-three average compensation (175,000). Therefore, the section 415(b) limitation applicable to Mr. Ellis's benefit at age 67 is $152,261. Mr. Ellis' age 67 benefit ($152,000) does not exceed the section 415(b) limitation applicable to him.

b. If the Plan has been amended to apply the section 415(b)(2)(E) changes under GATT (as amended by SBJPA) to all accrued benefits for all participants under the Plan:

The applicable dollar limit at age 67 is the lesser of the limit calculated using the plan rate and mortality, and the limit calculated using 5% and the applicable mortality table.

(i) The age 67 dollar limit is calculated using the same methodology as shown in part (a) above, but using the plan factors of 6% and UP-1984.

$$\frac{130{,}000 \times 9.345 \times (1.06)^2}{8.833}$$

$$= 154{,}535$$

(ii) The age 67 dollar limit is calculated using the same methodology as shown in part (a) above, but using 5% interest and the applicable mortality table.

$$\frac{130{,}000 \times 11.534 \times (1.05)^2}{10.894}$$

$$= 151{,}745$$

The dollar limitation applicable to Mr. Ellis is the lesser of the amounts in (i) and (ii), or $151,745. Because this amount is less than

the compensation limit applicable to Mr. Ellis, this limit is the applicable section 415(b) limit.

Mr. Ellis' plan benefit of $152,000 exceeds the section 415(b) limit applicable to his benefit. His benefit is limited to $151,745.

Rev. Rul. 98-1 Provides Guidance And Transition Rules After SBJPA

Rev. Rul. 98-1 reexamines many of the questions addressed in Rev. Rul. 95-29 to incorporate the changes made to RPA '94 (included in GATT) by SBJPA, and provides general rules and effective dates applicable to the changes. Both Rev. Rul. 95-29 and Rev. Rul. 98-1 provide that plans that are not subject to section 417(e)(3) (such as governmental plans and certain church plans), while not subject to the interest rate requirement under section 415(b)(2)(E)(ii), are subject to the mortality table requirement under section 415(b)(2)(E)(v).

Transition rules regarding the application of the section 415(b)(2)(E) changes are provided in section 2 of Rev. Rul. 98-1. The section 415(b)(2)(E) changes generally must be applied to all benefits under a plan on and after the RPA '94 (GATT) section 415 effective date (generally the first day of the first limitation year beginning in 1995). However, under section 767(d)(3)(A) of RPA '94 (GATT), as amended by section 1449(a) of SBJPA, a plan adopted and in effect before December 8, 1994, may provide that the section 415(b)(2)(E) changes do not apply with respect to benefits accrued before the **earlier** of (i) the date a plan amendment applying the section 415(b)(2)(E) changes is adopted or made effective, whichever is later, or (ii) the first day of the first limitation year beginning after December 31, 1999. Rev. Rul. 98-1 refers to the earlier of the dates in (i) and (ii) above as the "final implementation date", and refers to the benefits to which the section 415(b)(2)(E) changes are not applied as "old-law benefits".

Old-Law Benefits

A participant's old-law benefit is determined as of a date specified in the plan for the participant (called the participant's "freeze date") that is before the final implementation date. The plan may specify such an earlier date as the freeze date for some or all participants. The participant's old-law benefit is determined for each possible annuity starting date and optional form of benefit based on the participant's accrued benefit under the terms of the plan as of the participant's freeze date, after applying section 415 as in

effect on December 7, 1994 ("old-law limitations"), including the participation requirements under section 415(b)(5).

The old-law limitations are applied using the interest rate and mortality table for the optional form or commencement date under the plan as in effect on December 7, 1994, (that is, without regard to amendments affecting such actuarial equivalence factors made after December 7, 1994). (Note, however, that for purposes of determining the old-law benefit, an amendment after that date but before the freeze date to change benefits, for example from 1 percent of pay to 2 percent of pay, would not be ignored.) Therefore, except as provided in Q&A-15 of Rev. Rul. 98-1, in determining the old-law benefit, the section 415(b) limitations are applied using the plan's mortality table (as in effect on December 7, 1994) and, except as provided in section 415(b)(2)(D), an interest rate no less than the greater of 5 percent or the plan rate (as in effect on December 7, 1994), to determine actuarial equivalence. Note that if the plan rate for a particular optional form is a variable rate, the rate at the time the old-law limitations are applied, not the rate on December 7, 1994, is the plan rate that would be compared to 5 percent.

EXAMPLE (20):

Plan X, with a calendar year plan year and limitation year, is amended July 1, 1999, to apply the section 415(b)(2)(E) changes, effective January 1, 2000. As amended, Plan X provides that the section 415(b)(2)(E) changes will not apply toany benefits accrued under the plan as of December 31, 1999. What are the freeze date and the final implementation date for Plan X?

SOLUTION:

The freeze date for all participants is December 31, 1999. The final implementation date is the earlier of (i) the amendment's adoption date (July 1, 1999) or the amendment's effective date (January 1, 2000), whichever is later, or (ii) the first day of the first limitation year beginning after December 31, 1999 (January 1, 2000). Because (i) and (ii) are both equal to January 1, 2000, the final implementation date is January 1, 2000.

Example (21):

Plan B has a calendar year plan year and limitation year. Plan B is amended on December 1, 1998, to apply the section 415(b)(2)(E) changes effective January 1, 1998, and provides that the changes will not apply to benefits accrued through December 31, 1997. What are the freeze date and the final implementation date for Plan B?

SOLUTION:

The freeze date for all participants is December 31, 1997. The final implementation date is the earlier of (i) the amendment adoption date (December 1, 1998) or effective date (January 1, 1998), whichever is later, or (ii) the first day of the first limitation year beginning after 1999 (January 1, 2000). The final implementation date is December 1, 1998.

> Except as provided in Q&A-15, plan amendments adopted after the participant's freeze date are not taken into account in determining the old-law benefit, and the old-law benefit is determined without regard to cost-of-living adjustments under section 415(d) that become effective after the participant's freeze date.

EXAMPLE (22):

The following facts apply for this example and the next example. (These examples are similar to examples used in Rev. Rul. 98-1, but use a different SSRA.)

Plan B has a calendar year plan year and limitation year. As of December 7, 1994, the plan provides the normal retirement benefit in the form of a straight life annuity beginning at age 65 (NRA). Early retirement benefits are available at any age on or after age 60 with an actuarial reduction. The plan rate and the plan mortality table used for the reduction are 5 percent and the UP-1984 Mortality Table. Under the plan, single-sum distributions are available at any permitted retirement age.

Under Plan B, single-sum distributions are calculated as the actuarial present value of the straight life annuity benefit payable at the actual retirement age using the PBGC immediate interest rate and the UP-1984 Mortality Table. In accordance with section 417(e) and the regulations thereunder, the plan further provides that any single-sum

distribution must be at least as great as the actuarial present value of the participant's accrued normal retirement benefit computed using the PBGC interest rates for deferred annuities and the UP-1984 Mortality Table. The plan has not been amended to change the interest rate or mortality table used for determining single-sum benefits or early retirement reductions at any time after December 7, 1994.

Under Plan B, there is no forfeiture of accrued benefits on account of death prior to the annuity starting date, the section 415(b) limitations are applied only after the otherwise determined benefit has been adjusted for early retirement and for any optional form of benefit and, for purposes of adjusting the dollar limitation, the mortality decrement is ignored prior to age 62.

Plan B is amended on December 1, 1998, to apply the section 415(b)(2)(E) changes and provides that the changes will not apply to benefits accrued through December 31, 1997. (Thus, the freeze date is December 31, 1997, and the final implementation date is December 1, 1998.)

N, a participant of Plan B, has a SSRA of 66. As of the freeze date, N has 10 years of participation and has an accrued benefit payable at NRA (before application of section 415) of $110,000 per year, paid monthly. N would like to retire in 1999 at age 60 and receive the retirement benefit (with proper spousal consent) in the form of a single sum. Assume that N's high-three year compensation exceeds the dollar limitation for all years.

Question. How is N's old-law age 60 single-sum benefit determined?

SOLUTION:

First (step 1), N's accrued benefit as of the freeze date, payable at age 60 in the form of a single sum, must be determined and converted to an equivalent annual benefit payable at age 60. Secondly (step 2), the lesser of the old-law dollar limitation applicable to an annual benefit at age 60 and the compensation limitation applicable to N must be determined. Thirdly, (step 3) the equivalent annual benefit payable at age 60 must not exceed the limitation applicable to N at age 60. N's old-law benefit is the benefit accrued as of the freeze date, limited as necessary to satisfy section 415 where an old-law dollar limitation is used.

Step 1: Determine the equivalent annual benefit payable at age 60.

(i) N's age 60 early retirement **annuity** benefit under the Plan (prior to limitation for §415) as of the freeze date must be determined.

N's annuity benefit under the Plan as of the freeze date and payable at NRA ($110,000), is reduced to an annuity benefit payable at age 60 ($75,242) using the plan early retirement factors (5 percent and the UP-1984 Mortality Table), as shown below.

Note: the symbol $\ddot{a}_x^{(12)}$ represents the cost at age "x" of an annuity, paid monthly, commencing at age "x", and has the same value as the symbol

$$\frac{N_x^{(12)}}{D_x}$$

$$\frac{110{,}000 \times \ddot{a}_{65}^{(12)} \times 1/[(1.05)^5]}{\ddot{a}_{60}^{(12)}}$$

$$= \frac{110{,}000 \times 10.036 \times 1/[(1.05)^5]}{11.496}$$

$$= 75{,}242$$

(ii) The **single-sum** equivalent of N's age 60 annuity benefit as of the freeze date must be determined.

The single-sum benefit accrued as of N's freeze date and payable at age 60 is $797,264, calculated as shown below using the PBGC immediate rate of 6 percent and the UP-1984 Mortality Table.

$$75{,}242 \times \ddot{a}_{60}^{(12)}$$

$$= 75{,}242 \times 10.596 = 797{,}264$$

(iii) For purposes of §415 testing, the **annual benefit** equivalent to N's age 60 single-sum benefit under the Plan as of the freeze date must be determined.

N's age 60 single-sum benefit ($797,264) is converted to an annual benefit

of $75,242, using the greater of the plan rate of 6% or 5%, (6%), and the plan mortality table (UP-1984 Mortality Table), as shown below.

(797,264)/(10.596) = 75,242

Step 2: Determine the old-law limitation applicable to this optional form.

The age-adjusted dollar limit at age 60 must be determined on the basis of section 415(b)(2)(E) as in effect on December 7, 1994 [using the greater of 5 percent or the plan early retirement rate (also 5 percent) and the plan mortality (UP-1984 Mortality Table)], without taking into account COLA increases under section 415(d) after the freeze date (December 31, 1997).

The 1997 dollar limitation ($125,000) is adjusted to $80,759, as shown below.

(i) $125,000 is adjusted from age 66 (N's SSRA) to age 62, using Notice 87-21 factors:

125,000 x [1 - (5/9)(.01)(36) - (5/12)(.01)(12)]
= 125,000 x 75% = 93,750

(ii) $93,750 is adjusted from age 62 to age 60, using 5% and UP-1984:

$$\frac{93{,}750 \times \ddot{a}^{(12)}_{62} \times 1/[(1.05)^2]}{\ddot{a}^{(12)}_{60}}$$

$$= \frac{93{,}750 \times 10.918 \times 1/[(1.05)^2]}{11.496}$$

= 80,759

Because the old-law dollar limitation ($80,759) applies (the compensation limitation applicable to N is greater), and the age 60 annual benefit ($75,242) equivalent to the age 60 single-sum benefit ($797,264) does not exceed this old-law limitation, the single-sum old-law benefit at age 60 is $797,264.

Application of Section 415 Limitations Where Section 415(b)(2)(E) Changes Are Not Applied to Old-Law Benefits

There are three methods (Method 1, Method 2, and Method 3) which can be used to apply the limitations of section 415(b) in cases where the section 415(b)(2)(E) changes are not applied to old-law benefits. **The plan must specify which of the methods is being used and the way it is applied under the plan.**

Method 1.

Under Method 1, the 415(b) limitations are applied separately with respect to the old-law benefit (not to exceed the total plan benefit) and the portion of the total plan benefit that exceeds the old-law benefit.

The annual benefit that is equivalent to the old-law benefit is determined in accordance with section 415(b)(2)(E) as in effect on December 7, 1994.

The annual benefit that is equivalent to the portion of the plan benefit in excess of the old-law benefit must reflect the section 415(b)(2)(E) changes.

The total equivalent annual benefit is the sum of these two amounts. This total amount is then compared to the lesser of the age-adjusted dollar limit or the compensation limit.

In accordance with section 767(d)(3)(A) of GATT as amended by SBJPA, if the determination is being made before the final implementation date, then the plan rate and plan mortality table used in determining the annual benefit that is equivalent to the old-law benefit are based on the plan provisions in effect on December 7, 1994. If the determination is being made on or after the final implementation date, then the plan rate and plan mortality table used in determining the annual benefit that is equivalent to the old-law benefit are based on the plan provisions in effect on the date of determination.

The equivalent annual benefit cannot exceed the dollar limitation in

effect on the determination date, adjusted as necessary for early commencement or less than 10 years of participation. The use of the applicable mortality table in adjusting the current dollar limitation for early commencement of benefits could result in an age-adjusted dollar limit lower than the age-adjusted dollar limit used in the determining the old-law benefit. **A plan using Method 1 may provide that a participant will receive no less than the old-law benefit, limited to the extent required under Q&A-15 of Rev. Rul. 98-1.**

Method 2.

Under Method 2, the plan applies the section 415(b) limitations to the total plan benefit, but **provides that in any event the participant will receive no less than the old-law benefit, limited to the extent required under Q&A-15 of Rev. Rul. 98-1.**

Method 3.

Under Method 3, the plan applies the section 415(b) limitations by limiting a benefit only to the extent needed to satisfy either Method 1 or Method 2 above.

EXAMPLE (23):

In the previous example, N's age 60 single-sum old-law benefit was determined as $797,264. If N's total single-sum benefit payable in 1999 at age 60 is $950,000, how are the section 415 limitations applied to N's benefit in the three situations described below? (Assume that the applicable dollar limitation in 1999 is $130,000, and note that a determination in 1999 is after the plan's final implementation date which is December 1, 1998.)

Situation 1:

Plan B is amended to apply the section 415(b)(2)(E) changes in accordance with Method 1, and, as allowed by Method 1, provides that a participant will receive no less than the benefits accrued through December 31, 1997, limited to the extent required under Q&A-15 of Rev. Rul. 98-1. How are the section 415 limitations applied to N's benefit?

SOLUTION:

In general, to apply the section 415 limitations to N's benefit (payable at age 60 in the form of a single sum), the equivalent annual benefit is computed separately with respect to N's single-sum old-law benefit and the portion of N's total single-sum benefit that exceeds the single-sum old-law benefit. Once calculated, these two amounts are added together to determine N's total equivalent annual benefit. The sum of these annual benefits must not exceed the section 415 limitation (calculated taking the section 415(b)(2)(E) changes into account) applicable to N's benefit.

Step 1. Determine the annual benefit equivalent to N's single-sum old-law benefit (797,264) and determine the annual benefit equivalent to the portion of N's total benefit that exceeds the single-sum old-law benefit.

Note that if the determination of the annual benefit payable at age 60 that is equivalent to N's single-sum old-law benefit of $797,264 is done before the final implementation date, all plan terms in effect on December 7, 1994, that are relevant in determining actuarial equivalence under section 415(b)(2)(E) would be used. Because the determination is done on or after the final implementation date (December 1, 1998), actuarial equivalence is determined taking into account any amendments that affect the plan rate and plan mortality table that are adopted or become effective after December 7, 1994 (e.g., an amendment applying the GATT changes to section 417(e) to all benefits, adopted and effective after the freeze date and before the final implementation date). However, in this case, there have been no amendments after December 7, 1994, and the interest rate used for this adjustment is the greater of the plan rate for determining single sums (6 percent) or 5 percent, and the plan mortality table for determining single sums (the UP-1984 Mortality Table).

The annual benefit equivalent to the old-law single-sum benefit is $75,242, calculated as shown below.

797,264 / 10.596 = 75,242

The annual benefit equivalent to the excess portion of the age 60 single-sum benefit, $152,736 (950,000 - 797,264), must be determined, taking the section 415(b)(2)(E) changes into account. The annual benefit equivalent to the excess portion of the age 60 single sum, $152,736, is $15,125, which is the **greater** of the annual benefit at age 60 calculated using the plan rate and plan mortality (6

percent and the UP-1984 Mortality Table) and the annual benefit at age 60 calculated using the applicable rate (8 percent) and the applicable mortality table. The calculation of this annual benefit is shown below.

using 6% and UP-1984:

$$152{,}736 \div \ddot{a}_{60}^{(12)}$$

$$= 152{,}736 \div 10.596 = 14{,}415$$

using 8% and the applicable table:

$$152{,}736 \div \ddot{a}_{60}^{(12)}$$

$$= 152{,}736 \div 10.098 = 15{,}125$$

Thus, the **total benefit** to which the section 415 limitation is applied is $90,367 (75,242 + 15,125).

Step 2. Determine the age 60 section 415 limitation applicable to N's benefit, using the section 415(b)(2)(E) changes.

Adjusting the 1999 dollar limitation, $130,000, from age 66 (N's SSRA) to age 62, using Notice 87-21 factors:

$$130{,}000 \times [1 - (5/9)(.01)(36) - (5/12)(.01)(12)]$$
$$= 130{,}000 \times 75\% = 97{,}500$$

Adjusting $97,500 from age 62 to age 60, **using the plan rate and mortality table (UP-1984 and 5%)**:

$$\{97{,}500 \times \ddot{a}_{62}^{(12)} \times 1/[(1.05)^2]\} \div \ddot{a}_{60}^{(12)}$$

$$= \{97{,}500 \times 10.918 \times 1/[(1.05)^2]\} \div 11.496$$
$$= 83{,}989$$

Adjusting $97,500 from age 62 to age 60, **using 5 percent and the applicable mortality table**:

$$\{97{,}500 \times \ddot{a}_{62}^{(12)} \times 1/[(1.05)^2]\} \div \ddot{a}_{60}^{(12)}$$

$$= \{97{,}500 \times 12.456 \times 1/[(1.05)^2]\} \div 13.037$$
$$= 84{,}494$$

The applicable dollar limitation is the lesser of $83,989 and $84,494, which is $83,989.

Conclusion: N's total single-sum benefit at age 60, when expressed as an annual benefit ($90,367), exceeds the dollar limitation at age 60 ($83,989). Therefore, N's single sum benefit must be limited in order to satisfy section 415 to 885,591, as shown below.

The permissible annual benefit in excess of the old-law benefit is

$83,989 - $75,242 = $8,747.

The total single sum is limited to the single-sum "old-law benefit" plus the single-sum equivalent of $8,747, calculated using the section 415(b)(2)(E) changes (i.e., using the applicable rate (8%) and applicable table). The permissible total single sum at age 60 is $885,591, calculated as shown below.

$797,264 + $8,747 (10.098)
= $797,264 + $88,327 = $885,591

SITUATION 2:

Plan B is amended to apply the section 415(b)(2)(E) changes in accordance with Method 2 (i.e., the changes will apply to the total plan benefit), but participants will receive no less than the old-law benefit, limited to the extent provided in Q&A-15 of Rev. Rul. 98-1. How are the section 415 limitations applied to N's benefit?

SOLUTION:

The total single-sum benefit ($950,000) is converted to an equivalent annual benefit which is the **greater** of (i) and (ii):

(i) the benefit calculated using the plan factors (6% and the UP-1984 Mortality Table);

$950{,}000 \div \ddot{a}_{60}^{(12)} = 950{,}000 \div 10.596 = 89{,}656$

and

(ii) the benefit calculated using the applicable rate (8%) and the applicable table.

$950{,}000 \div \ddot{a}_{60}^{(12)} = 950{,}000 \div 10.098 = 94{,}078.$

The greater benefit, $94,078, exceeds the age 60 dollar limitation (determined in situation 1 as $83,989). Therefore, in order to satisfy section 415(b), the single-sum benefit must be limited to

$83{,}989 \times 10.098 = \$848{,}121$

(calculated using the applicable rate and mortality table).

SITUATION 3:

Plan B is amended to provide that, in accordance with Method 3, a benefit is limited only to the extent necessary the satisfy the section 415(b) limitations using either Method 1 or Method 2. How are the section 415 limitations applied to N's benefit?

SOLUTION:

The maximum benefit that satisfies section 415(b) is $885,591 under Method 1 and $848,121 under Method 2. Therefore, the maximum benefit that satisfies section 415(b) in accordance with Method 3 is $885,591.

Circumstances Under Which Old-Law Benefits Can Change

While a participant's old-law benefit cannot increase after the participant's freeze date, under certain circumstances it could decrease. Q&A-15 of Rev. Rul. 98-1 provides examples where such a reduction could occur.

If the old-law limitations as of a date after a participant's freeze date are less

than the old-law benefit determined as of the participant's freeze date, the participant's old-law benefit must be limited.

For example, allocations made on behalf of a participant after their freeze date under a DC plan of the same employer (for a limitation year during which section 415(e) is still in effect, i.e. a limitation year beginning before January 1, 2000) increase the participant's defined contribution plan fraction, possibly changing the participant's defined benefit fraction (depending on the plan terms). If a participant's defined benefit plan fraction is decreased, further limitation of the participant's old-law benefit could be required.

On or after the final implementation date, determinations of actuarial equivalence under section 415(b)(2)(E) that apply to old-law benefits must take into account any changes in plan terms relevant in applying old-law limitations that occur after December 7, 1994. If the equivalent annual benefit determined in this manner exceeds the age-adjusted dollar limitation, the old-law benefit must be limited accordingly.

Additionally, the old-law benefit is limited to the extent that the total plan benefit determined before applying section 415 under the plan is smaller than the old-law benefit.

Plan Funding And Section 415(b)(2)(E) Changes

Plan funding is based on projected benefits, calculated under the terms of the plan and payable at normal retirement age, or other ages permitted under plan terms. If a plan has not yet been amended to reflect the section 415(b)(2)(E) changes, funding on the basis of current plan terms could result in the plan being funded for projected benefits (including benefits to be earned for years after 1999 when lesser limitations could apply) that exceed the section 415(b) limitations. Section 404(j) provides that benefits exceeding the section 415 limitation must not be taken into account in computing deductions.

Thus an employer could be required to contribute amounts under section 412 (for projected benefits currently provided under the terms of the plan) which are not deductible under section 404. Once a plan is amended to reflect the section 415(b)(2)(E) changes, projected benefits provided under the plan should comply with the section 415 limitations in effect and, provided that benefits and contributions are calculated correctly and

limitations are properly applied, funding for such benefits should be deductible under section 404.

Relief is provided for plans that have not been amended to apply the section 415(b)(2)(E) changes to avoid the potential deduction problem discussed above in Q&A-19 and Q&A-20 of Rev. Rul. 98-1.

Q&A-19 of Rev. Rul. 98-1 provides rules under which the section 415(b)(2)(E) changes may be anticipated. Reg. section 1.412(c)(3)-1(d)(1) provides in general that, except as otherwise provided by the Commissioner, a reasonable funding method does not anticipate changes in plan benefits that become effective, whether or not retroactively, in a future plan year or that become effective after the first day of, but during, a current plan year. However, under Q&A-19 of Rev. Rul. 98-1 a plan that is operated in accordance with the section 415(b)(2)(E) changes is permitted to anticipate a plan amendment applying the section 415(b)(2)(E) changes for purposes of section 412 until the plan's final implementation date(s). For plan years beginning on or after January 1, 1997, a plan amendment applying the section 415(b)(2)(E) changes may be anticipated only if the plan amendment is permitted under Rev. Rul. 98-1 and only if it is described in an attachment to a Schedule B of Form 5500 for the plan year (that is filed on or before the due date, including extensions, for such Schedule B).

The attachment must specify the extent to which the anticipated plan amendment provides that the section 415(b)(2)(E) changes will not apply to participants' old-law benefits (including, if applicable, any freeze date described in Q&A-13 and which method (Method 1, 2, or 3) described in Q&A-14 will be used to apply the limitations of section 415). If the section 415(b)(2)(E) changes are retroactively applied to all benefits under the plan, this must be specified in the attachment. Additionally, once a Schedule B is filed for a plan year, the anticipated amendment, if any, that was used in applying section 412 for that year cannot be changed (for purposes of applying section 412 for that year). Note, however, that the anticipated amendment may be changed for a later plan year without affecting what was done for a prior plan year.

If no such attachment is made to the Schedule B for a plan year, the employer may not anticipate the section 415(b)(2)(E) changes for that plan year and must determine the minimum funding standard using the terms of the plan.

Q&A-20 of Rev. Rul. 98-1 further provides that, for taxable years relating to plan years beginning prior to January 1, 1997, the Service will not assert a violation of section 404(j) merely because contributions are made in amounts necessary to satisfy minimum funding standards calculated based on the terms of the plan, provided that the terms of the plan satisfy old-law limitations. This provision will not apply with respect to a plan year if a Schedule B of Form 5500 has been filed for that plan year prior to January 12, 1998, for which the minimum funding standards have been calculated by anticipating an amendment applying the section 415(b)(2)(E) changes.

Draft Memorandum Circulated To The Field

A draft memorandum to the Field, dated February 11, 1998, summarizes required amendments for terminating plans with regard to section 415(b)(2)(E) changes under GATT and SBJPA. A copy of this draft memorandum is included at the end of this chapter.

Adjustment For Less Than 10 Years Of Participation Or Service

Where a participant has less than 10 years of service or participation, section 415(b)(5) provides for a reduction in the limitations applicable to that participant.

In the case of an employee who has less than 10 years of participation in a defined benefit plan, the dollar limitation of IRC section 415(b)(1)(A) is multiplied by a fraction, (i) the numerator of which is the number of years (or part thereof) of participation in the defined benefit plan of the employer, and (ii) the denominator of which is 10.

In determining a participant's years of participation for these purposes, Q&A-7 of Notice 87-21 provides that a participant is credited with a year of participation (computed to fractional parts of a year) for each accrual computation period for which the following conditions are met: (1) the participant is credited with at least the number of hours of service, or period of service if the elapsed time method is used for benefit accrual purposes, required under the terms of the plan in order to accrue a benefit for the accrual computation period, and (2) the participant is included as a plan participant under the eligibility provisions of the plan for at least one day of the accrual computation period. If these two conditions are met, the portion of a year of participation credited to the participant is equal to the amount of benefit accrual service credited to the participant for such accrual computation period.

Thus, where the terms of a plan provide that a participant with 50 hours of service earns a year of service for benefit accrual purposes, a participant with 50 hours of service could be credited with a year of participation for purposes of section 415(b)(5). Additionally, for a participant to receive a year (or part thereof) of participation for an accrual computation period, the plan must be established no later than the last day of such accrual computation period.

The compensation and benefits limitations of IRC section 415(b)(1)(B), IRC section 415(b)(4), and (for limitation years beginning before 2000) IRC section 415(e) are reduced in a similar manner except that such reduction is applied with respect to years of service (less than 10) with an employer rather than years of participation in a plan.

Thus, under the rules of section 415(b)(5) the DB dollar limitation is reduced where a participant has less than 10 years of **participation**, following the rules of section 415(b)(5)(A), and the DB compensation limitation is reduced where a participant has less than 10 years of **service**, following the rules of section 415(b)(5)(B).

Limitation on reduction.

> In no event shall the reductions of IRC sections 415(b)(5)(A) or (B) reduce the limitations referred to in section 415(b)(1) and section 415(b)(4) to an amount less that 1/10 of such limitation determined without regard to section 415(b)(5).

EXAMPLE (24):

"A" has participated in Corporation B's defined benefit plan for six years and has seven years of service with the employer at the time of his retirement in 1996 at age 65 (A's social security retirement age). A's benefit on retirement is a straight life annuity based on average compensation for his high three years of $50,000.

The section 415(b) limitation which will apply to A's benefit will be the lesser of the dollar limit applicable to A's benefit (72,000 = 120,000 x (6/10)) and the percentage of compensation limitation applicable to A (35,000 = 50,000 x (7/10)). Therefore, A's benefit may not exceed $35,000 at age 65 (100% of A's high three compensation, reduced for less than 10 years of service).

EXAMPLE (25):

"B" participated in the corporation's DB plan for seven years before retiring in 1997 at age 65 (B's social security retirement age) with eight years of service, being then entitled to a straight life annuity benefit based on high-three average compensation of $70,000. B's benefit may not exceed the lesser of:

$70,000 x 8/10 = $56,000 (the percentage of compensation limitation reduced for less than 10 years of **service**); or

$125,000 x 7/10 = $87,500 (the 1997 dollar limitation reduced for less than 10 years of **participation**).

Therefore, B's benefit may not exceed $56,000.

Qualified Domestic Relations Orders (QDROs) And Section 415

IRC section 414(p) provides rules which a domestic relations order must satisfy to be treated as a qualified domestic relations order. Q&A-20 of Notice 87-21 states that benefits provided to alternate payees of participants pursuant to QDROs must be aggregated with benefits provided to participants from all defined benefit and defined contribution plans in applying the limitations of section 415. Thus, the aggregated distributions are subject to the single limitation applicable to the participant under sections 415(b), 415(c), and 415(e) (for limitation years beginning

before January 1, 2000). Although the aggregate amounts distributed are subject to a single section 415 limitation, there is no requirement that this limitation be split between the payees in any particular fashion. The general rule that is applied to the distributions is that the actuarial value of the amounts distributed may not exceed the actuarial value of the annual benefit that could be paid to the participant at the age the participant's benefit commences under the plan.

EXAMPLE (26):

In 1996, Mr. Hill, age 59, and his wife, age 54, divorce. Under the terms of a QDRO, Mr. Hill's former spouse will commence receiving a portion of Mr. Hill's retirement annuity benefit under a defined benefit plan, Plan D, in 1997 at age 55. Mr. Hill will commence benefits at his normal retirement age of 65, also his social security retirement age. How would the section 415(b) limitation be applied in these circumstances?

SOLUTION:

For purposes of section 415, the plan could distribute an annual benefit of $X for the life of the alternate payee, commencing at age 55, and $Y for the life of the participant, commencing at age 65, for any combination of $X and $Y that satisfied the relation:

$$(\$X)\ \frac{N_{55}^{(12)}}{D_{60}} + (\$Y)\ \frac{N_{65}^{(12)}}{D_{65}} = (\$125{,}000)\ \frac{N_{65}^{(12)}}{D_{65}}$$

(Remember that when Mr. Hill is 65, his former spouse will be 60.)

Of course, these calculations must be performed using assumptions that satisfy the requirements of IRC section 415(b)(2)(E).

Social Security Supplements And IRC Section 415

A social security supplement is generally a benefit that begins and terminates before the age when a participant is entitled to old-age insurance benefits, and does not exceed the old-age insurance benefit which the participant will receive at the applicable age. Social security supplements are benefits that are directly related to retirement benefits and, therefore, are taken into account for IRC 415

purposes, although they are not accrued benefits for IRC 411 purposes (see Reg. 1.411(a)-7(c)(4)).

EXAMPLE (27):

Under Plan R, when participant West retires at age 60 he will receive his age 60 retirement benefit plus a social security supplement. Mr. West will receive the social security supplement from age 60 to age 65, his social security retirement age. How is the IRC 415(b) dollar limitation applied to Mr. West's benefit?

SOLUTION:

The social security supplement plus the retirement benefit to be paid to Mr. West, when converted to an actuarially equivalent straight life annuity commencing at age 60 using assumptions which satisfy section 415(b)(2)(E), must not exceed (must be less than or equal to) the IRC 415(b) dollar limitation, adjusted for commencement at age 60. That is, the following relation must be satisfied at age 60.

$$\frac{\text{Pres. Value Soc. Sec. Supp.}}{\ddot{a}_{60}} + \text{Pres. Value Age 60 Ret. Ben.} \leq \text{IRC 415(b) dollar limitation reduced for age 60 commencement}$$

Special Minimum Benefit Of $10,000

IRC section 415(b)(4) provides that defined benefit plans may provide for a minimum $10,000 annual benefit on behalf of any participant regardless of the limitation on benefits and regardless of the age at which benefits commence provided that

1. The $10,000 benefit is the maximum employer-derived retirement benefit under all plans maintained by the same employer, and

2. The employer has never maintained a defined contribution plan in which the participant participated.

It is important to realize that (1) this $10,000 annual benefit is subject to reduction for service of less than 10 years, according to the rules of section 415(b)(5)(B), and (2) this exception provides only for a minimum benefit paid in the form of an annuity (a $10,000 annual benefit), and is not adjusted upward for early retirement provisions and benefits which are not in the form of a straight life annuity (for example, a participant cannot under this exception receive the present value of a $10,000 per year annuity as a single sum). (See Reg. section 1.415-3(f)(4).)

EXAMPLE (28):

Mr. Levin participates in Plan X, a DB plan, and reaches the plan's NRA of 65 with nine years of service with the employer, and a high-three average compensation at NRA of $8,900. Under the terms of Plan X, Mr. Levin will receive the special $10,000 annual benefit derived from employer contributions. For purposes of applying the special $10,000 limitation to Mr. Levin's benefit, such limitation would be reduced to $9,000 ($10,000 x 9/10) because Mr. Levin had less than 10 years of service. Thus, if the conditions under section 415(b)(4) are satisfied, the otherwise applicable limitation on Mr. Levin's benefit under section 415(b)(1) of $8,010 ($8,900 x (9/10), 100% of Mr. Levin's high three average compensation reduced for less than 10 years of service) would not reduce Mr. Levin's benefit below $9000.

Note that employee contributions are not considered a separate defined contribution plan for purposes of applying this special limitation, so the fact that a defined benefit plan provides for employee contributions does not preclude a plan from taking advantage of this special exception. (See Reg. section 1.415-3(f)(3).)

Examination Steps

1. What is the normal form of the retirement benefit under the plan?

    a. Where a plan provides for optional forms of benefit, other than in the form or a single life annuity or a qualified joint and survivor annuity, do the plan terms provide the actuarial assumptions to be used for determining actuarial equivalence for other forms of benefit?

b. For purposes of IRC 415(b) testing, are those forms of benefit which require adjustments correctly converted to an actuarially equivalent single life annuity commencing at the same age? Are assumptions which satisfy section 415(b)(2)(E) used for these calculations?

2. What is the normal retirement age under each plan?

a. Where a participant's benefit commences before their SSRA, is the IRC 415(b) dollar limitation adjusted correctly, using assumptions which satisfy section 415(b)(2)(E)?

b. Where a participant's benefit commences after their SSRA, is the IRC 415(b) dollar limitation properly adjusted for such late commencement, using assumptions which satisfy section 415(b)(2)(E)?

c. Does the use of mortality in adjusting the dollar limitation for early or late commencement satisfy the rules found in Q&A G-4 of Notice 83-10 and Q&A-5 of Notice 87-21?

3. For participants with less than 10 years of participation, is the dollar limitation of IRC 415(b)(1)(A) reduced appropriately?

4. For participants with less than 10 years of service, is the compensation limitation of IRC 415(b)(1)(B) reduced appropriately? For participants with less than 10 years of service, are the limitations used in IRC 415(e) calculations (for limitation years beginning before January 1, 2000), and, if applicable, the special $10,000 limitation of IRC 415(b)(4) reduced appropriately?

5. Where a portion of a participant's benefit is paid to an alternate payee under a qualified domestic relations order, does the sum of the actuarial values of the amounts distributed exceed the actuarial value of the maximum annual benefit that could be paid to the participant at the age the participant's benefit commences under the plan?

6. Are benefits under all DB plans of the employer aggregated for purposes of applying the limitations of IRC 415(b)?

SBJPA And Taxpayer Relief Act of 1997 Amend Section 415(b) Rules Affecting Government Plans

Prior Law

Section 415(b)(2)(F) provides that for plans maintained by governments (where the employer has not made the election described in Code section 415(b)(10)) and tax-exempt organizations, (1) age 62 is used in place of the SSRA in section 415(b)(2)(C), and the reduction under section 415(b)(2)(C) shall not reduce the dollar limitation below (i) $75,000 if the benefit begins at or after age 55, or (ii) if the benefit begins before age 55, the equivalent of the $75,000 limitation for age 55, and (2) age 65 is used in place of the SSRA in section 415(b)(2)(D). For qualified police and firefighters, section 415(b)(2)(G) further provides that the dollar limitation is not reduced below $50,000, adjusted for COLAs, under section 415(b)(2)(C) (where benefits commence before age 55).

Section 415(b)(10), added to the Code by TAMRA '88, provides rules for state and local government plans where the employer elected before the close of the first plan year beginning after December 31, 1989, to have section 415(b) (other than section 415(b)(2)(G)) apply without regard to the government plan exceptions under section 415(b)(2)(F). These rules provide that for participants who first became a participant in such plans prior to 1990, the section 415(b) limitation shall not be less than their accrued benefit under the plan, determined without regard to any amendments made to the plan after October 14, 1987. Thus, for these participants, benefits which continue to accrue under the terms of the plan as of October 14, 1987, will be treated as not exceeding the section 415(b) limitations. For participants who first became participants on or after January 1, 1990, the applicable section 415(b) limitation is determined without regard to the governmental plan exceptions under section 415(b)(2)(F).

SBJPA Amendments

SBJPA (section 1444(a)) added section 415(b)(11) to the Code which provides that in the case of a governmental plan (as defined in section 414(d)), section 415(b)(1)(B) does not apply. That is, governmental plans are not subject to the 100 percent of high three-year average compensation limitation. Thus, the only limitation applicable to governmental plans under section 415(b)(1) is the dollar limitation, and if section 415(b)(10) does not apply, the usual exceptions provided under section 415(b)(2)(F) still apply.

SBJPA (section 1444(b)) added section 415(m) to the Code which provides that in determining whether a governmental plan satisfies section 415, benefits provided under a qualified governmental excess benefit arrangement are not taken into account. A governmental excess benefit arrangement is defined as a portion of a governmental plan: (A) which is maintained solely for the purpose of providing that part of a participant's annual benefit otherwise payable under the terms of the plan that exceeds the limitation on benefits; (B) under such portion, no election is provided at any time to the participant (directly or indirectly) to defer compensation; and (C) benefits described in (A) are not paid from a trust forming a part of such governmental plan unless such trust is maintained solely for the purpose of providing such benefits. Rules regarding the treatment of income accruing under such plans and the taxation of participants are also provided in section 415(m).

Section 1444(c) of SBJPA added section 415(b)(2)(I) to the Code which provides that sections 415(b)(2)(C) and 415(b)(5) do not apply to (i) income received from governmental plans (as defined in section 414(d)) as a pension, annuity, or similar allowance as the result of the recipient becoming disabled by reason of personal injuries or sickness, or (ii) amounts received from a governmental plan by the beneficiaries, survivors, or the estate of an employee as the result of the death of the employee.

Section 1444(d) of SBJPA added subsection (ii) to section 415(b)(10)(C)) which provides that an election under section 415(b)(10)(i) may be revoked not later than the last day of the third plan year beginning after the date of the enactment of this clause. The revocation applies to all plan years to which the election applied and to all subsequent plan years. This subsection further provides that amounts paid by a plan in a taxable year ending after the revocation are includible in income in such taxable year under the rules of this chapter in effect for such taxable year, except that, for purposes of applying the limitations imposed by section 415, any portion of such amount which is attributable to any taxable year during which the election was in effect are treated as received in such taxable year.

Sections 1444(a), (b), and (c) apply to years beginning after December 31, 1994, and section 1444(d) applies with respect to revocations adopted after the SBJPA enactment date (August 20, 1996) .

Taxpayer Relief Act Of 1997 (TRA '97) Amendments

TRA ’97 (section 1526) added section 415(n) to the Code, which provides special rules relating to the purchase of permissive service credit under governmental plans. If an employee makes contributions to a DB governmental plan to purchase permissive service credit, then the limitations of section 415(b) must be satisfied by treating the accrued benefit derived from such contributions as an annual benefit, or the requirements of section 415(c) must be satisfied by treating all such contributions as annual additions. However, if the benefit derived from such contributions is treated as an annual benefit, the plan shall not fail to satisfy the dollar limitation adjusted for early commencement of benefits under section 415(b)(2)(C) solely because of this subsection. If the contributions are treated as annual additions, the plan shall not fail the percentage of compensation limitation of section 415(c)(1)(B) solely because of this subsection.

Section 1526(a) defines permissive service credit and limits the number of permissible service credits that may be purchased for certain "nonqualified service" to five years and five years of plan participation is required before such nonqualified service may be taken into account.

Section 1526(b) of TRA ’97 added section 415(k)(3) to the Code which provides a special rule that repayment of contributions (including interest thereon) to a governmental plan with respect to an amount previously refunded upon a forfeiture of service credit under the plan or under another governmental plan maintained by a State or local government employer within the same State is not taken into account for purposes of this section (section 415).

The amendments under section 1526 apply to permissive service credit contributions made in years beginning after 1997. A transitional rule (section 1526(c)(2)(A)) provides that, for eligible participants, the limitations of section 415(c)(1) shall not be applied to reduce the amount of permissive service credit which may be purchased to an amount less than the amount which was allowed to be purchased under the terms of the plan as in effect on the date of enactment of TRA ’97.

TRA ’97 (section 1527) amended section 415(b)(2)(G) to provide that the early retirement reductions under section 415(b)(2)(C) to the dollar limitation do not apply to qualified police or firefighters as described in section 415(b)(2)(G), effective for years beginning after 1996.

COMBINED PLAN LIMITATIONS UNDER IRC SECTION 415(e)

The following discussion is applicable for limitation years beginning before January 1, 2000. Section 415(e) was repealed by section 1452(a) of SBJPA, effective for limitation years beginning after December 31, 1999.

Limitation Years Beginning Before The Year 2000

In the case of an employee who is covered under both a defined benefit plan and a defined contribution plan of the same employer, the total amount of benefits and contributions which the employee can accrue or receive is subject to an overall limitation which is set forth in IRC section 415(e). After all similar plans of the employer (in which an employee is or has been a participant) are aggregated, two fractions are computed: one for the defined benefit plan (as aggregated) and one for the defined contribution plan (as aggregated). Each fraction represents the ratio of benefits (or contributions) actually provided over the maximum benefits (or contributions) that could have been provided under the plan pursuant to IRC section 415. Generally, the sum of these two fractions may not exceed 1.0.

Defined Benefit Fraction

The defined benefit fraction (DBF) applicable to a participant for a limitation year is determined according to the rules found in IRC section 415(e)(2) and Reg. section 1.415-7(b), and is a ratio that compares the amount of benefit expected to be provided under the plan with the maximum benefit that could be provided under IRC section 415(b).

The numerator of the DBF is the participant's projected annual benefit (determined as of the close of the limitation year and in accordance with Reg. section 1.415-7(b)(3)), assuming that the participant continues employment until normal retirement age (as defined by the plan) and that all other factors (including level of average compensation) will remain constant throughout the participant's future working lifetime. The numerator of the DBF does not include any benefit derived from employee contributions or from rollover contributions.

Where a participant has separated from service, or ceased to accrue benefits under the plan, or where the plan has been terminated, the projected annual benefit is computed as the accrued benefit (that is, only credited service through the date the employee separates from service, or

ceases to accrue benefits, or the date the plan terminates, is taken into account).

The denominator of the DBF is a function of the limitations under IRC section 415(b), and is equal to the lesser of two amounts:

(i) 1.25 (125%) times the applicable dollar limitation under IRC section 415(b)(1)(A); or

(ii) 1.4 (140%) times the applicable high three-year average compensation limitation of IRC section 415(b)(1)(B).

When calculating the denominator of the DBF, it is assumed that the participant will continue in employment until normal retirement age. In certain top-heavy situations, the amount in (i) above may be lower.

EXAMPLE (29):

Ms. Thomas is a participant in a DB plan (Plan K) maintained by her employer, with whom she has 5 years of service. The plan year and limitation year of Plan K are both the calendar year. Plan K has a NRA of 65, and the NRA plan benefit in the form of a single life annuity is equal to 2% of the final year's compensation multiplied by years of service. In 1992, Ms. Thomas has compensation of $40,000 and a high three-year average compensation of $38,850. Born in 1952, Ms. Thomas's age in 1992 is 40 and her SSRA is 66. What DBF is applicable to Ms. Thomas in 1992 for a benefit in the form of a single life annuity payable at age 65?

SOLUTION:

The numerator of the DBF will be Ms. Thomas' projected benefit at NRA, assuming that she continues in service until NRA, earning the same compensation, is

2% x $40,000 x 30 = $24,000

The denominator of the DBF will be the lesser of:

(1) 1.25 (125%) x the 1992 DB dollar limitation ($112,221) reduced for commencement 12 months before SSRA
= 1.25 x {$112,221 x [1 - (5/9)x(.01)x(12)]}
= 1.25 x {$112,221 x [1 - 1/15]}
= 1.25 x {$112,221 x (.933)}
= 1.25 x $104,740
= $130,925

or (2) 1.4 x $38,850 =$54,390
The lesser of (1) or (2) is $54,390

The DBF is then $24,000/$54,390 = .441

Defined Contribution Fraction

The defined contribution fraction (DCF) applicable to a participant for a limitation year is determined according to the rules found in IRC section 415(e)(3) and Reg. section 1.415-7(c), and is a ratio that compares the amount of contributions actually provided under the plan with the maximum that could have been provided under the plan. However, unlike the DBF, the DCF is a cumulative device. A participant's DCF is developed year-by-year, with the current year's DCF being determined, in part, by the DCF that had existed in the prior year. Also, unlike the DBF, a participant possesses only one DCF, the one that exists on the valuation date. To calculate a participant's DCF, it generally will be necessary to know the participant's salary history, the actual history of contributions to the participant's account, and the DC limits in effect for each year.

The numerator of the DCF is the sum of all annual additions made to the participant's account. Remember that the definition of annual additions has been amended and is different for limitation years beginning before January 1, 1987, and limitation years beginning after 1986, with respect to employee contributions. All employee contributions are included in the definition of annual additions for limitation years beginning after 1986, while the lesser of the employee contributions in excess of 6 percent of compensation or one-half of employee contributions is included for limitation years beginning before January 1, 1987. The DCF may also be affected by permanent subtraction adjustments made under transitional rules following TEFRA and TRA'86.

The denominator of the DCF is the sum of the maximum allowable annual additions to the participant's account for the limitation year and for each prior limitation year of the participant's service with the employer (regardless of whether a plan was in existence during those years). The denominator is the sum of the lesser of the following amounts determined for the limitation year and for each prior limitation year of the participant's service:

(i) 1.25 multiplied by the dollar limitation of section 415(c)(1)(A); or

(ii) 1.4 multiplied by the compensation limitation of section 415(c)(1)(B).

In certain top-heavy situations, the amount in (i) above may be less.

EXAMPLE (30):

Participant Ashley becomes employed on 1/1/88 and immediately participates in the employer's profit sharing plan. Salary for 1988 for Ashley is $35,000 and a contribution of $3,500 is made to Ashley's account. In 1989, Ashley's salary is increased to $150,000 and the 1989 contribution to Ashley's account is $15,000. There are no other annual additions in either 1988 or 1989. What is the DCF applicable to Ashley for 1988 and 1989? The profit sharing plan is not top-heavy.

SOLUTION:

(1) For 1988, the numerator of the DCF is $3,500, and the denominator is the lesser of

(i) 1.25 x $30,000 = $37,500, or
(ii) 1.4 x (25% x $35,000) = $12,250

which is $12,250.

The 1988 DCF is $3,500/$12,250 = .286

(2) For 1989, the numerator of the DCF is $18,500 ($3,500 + $15,000). The denominator is $12,250 (for 1988, from above) + for 1989, the lesser of

(i) 1.25 x $30,000 = $37,500, or

(ii) 1.4 x (25% x $150,000) = $52,500

which is $37,500

The 1989 DCF is $18,500/$49,750 = .372

Examination Steps

1. It is impossible to verify compliance with IRC section 415 without ascertaining whether the plan participants are covered under more than one plan. The specialist should determine whether there are any participants covered under two or more plans which are required to be combined or aggregated under Reg. section 1.415-8. If so, and if these plans comprise at least one DB plan and one DC plan (or, an arrangement described in IRC section 414(k)), then the specialist should investigate compliance with IRC section 415(e).

2. When constructing the denominator of the DBF, the dollar limit is reduced whenever the participant's projected years of **service** are less than ten. This is different than standard procedure under IRC section 415(b), which calls for such a reduction whenever the projected years of **participation** are less than ten. (This difference is called for under IRC section 415(b)(5)(B), as amended by the Technical and Miscellaneous Revenue Act of 1988 (TAMRA). Although enacted on November 10, 1988, this provision was made effective as if it were included in the Tax Reform Act of 1986 (TRA'86).)

3. When checking (or reconstructing) a participant's DCF, it generally will be necessary to know:

(i) the participant's actual salary history;

(ii) the actual history of contributions to the participant's account; and

(iii) the DC limits in effect for each year.

Employee Plans CPE Technical Topics for 1998

GATT AND SBJPA §415 PROCEDURAL MATTERS (written by Devonne Shaw)

Introduction

This section addresses the GATT and SBJPA remedial amendment period provided in Revenue Procedure 97-41, 1997-33 I.R.B. 51 ("Rev. Proc. 97-41") and whether a plan must be operated in compliance with the 415(b) changes made by GATT and SBJPA prior to being amended in accordance with the GATT and SBJPA requirements.

Remedial Amendment Period

Section 401(b) of the Code provides a remedial amendment period during which a plan may be amended retroactively, under certain circumstances, to comply with the Code's qualification requirements. The remedial amendment period applies to disqualifying provisions (defined in section 1.401(b)-1T(b)(3) of the Income Tax Regulations). In general, the remedial amendment period begins with the date on which the change becomes effective with respect to the plan, or in the case of a provision that is integral to a qualification requirement that has been changed, the first day on which the plan was operated in accordance with the provision as amended, and ends with the later of (1) the due date (including extensions) for filing the income tax return for the employer's taxable year that includes the date on which the remedial amendment period begins or (2) the last day of the plan year that includes the date on which the remedial amendment period begins. The Commissioner has authority under 1.401(b)-1(f) of the Regulations to extend the remedial amendment period.

In Rev. Proc. 97-41, pursuant to the authority under section 1.401(b)-1T(b)(3), the Commissioner designated as a disqualifying provision any provision that cause a plan to fail to satisfy the qualification requirements of the Code because of changes made to those requirements by SBJPA or GATT that are effective before the first day of the first plan year beginning on or after January 1, 1999. In Section 6.04 of Rev. Proc. 97-41 the remedial amendment period for SBJPA and GATT disqualifying provisions is extended to the last day of the first plan year beginning on or after January 1, 1999 ("the GATT and SBJPA Remedial Amendment Period"). Therefore, plans do not have to be amended to conform to the GATT and SBJPA changes until this date. Pursuant to Rev. Proc. 98-14, 1998-4 I.R.B. 22, the GATT and SBJPA remedial amendment period for governmental plans is extended to the later of (i) the last day of the last plan year beginning before January 1, 2001, or (ii) the last day of the first plan year beginning on or after the

"1999 legislative date."

Section 6.02 of Rev. Proc. 97-41 provides that a provision that causes a plan to fail to satisfy section 401(a) because of a change made by SBJPA or GATT to the qualification requirements that is effective on or after the first day of the first plan year beginning on or after January 1, 1999, is not a disqualifying provision. Also, a plan provision that is integral to a qualification requirement changed by SBJPA is not a disqualifying provision if the change in the qualification requirement is effective on or after the first day of the first plan year beginning on or after January 1, 1999, or if the plan provision as amended is not effective prior to the end of the GATT and SBJPA remedial amendment period. For example, since the repeal of the 415(e) combined limit by SBJPA is not effective until limitation years beginning after December 31, 1999, a plan provision that is integral to the 415(e) provision is not a disqualifying provision under Rev. Proc. 97-41.

The GATT and SBJPA remedial amendment period is different for terminating plans. Section 9 of Rev. Proc. 97-41 requires a plan, including a master or prototype, regional prototype, or volume submitter plan that is terminated after the effective date of changes in the qualification requirements made by SBJPA or GATT but before the date that plan amendments would otherwise be required must be amended in connection with the plan termination to comply with the changes as of their effective date with respect to the plan. For this purpose, any amendment that is adopted after the date of plan termination in order to receive a favorable determination letter will be considered as adopted in connection with the plan termination. In addition section 7 of Rev. Proc. 97-41 provides that annuity contracts distributed from such terminated plans also must meet all the applicable requirements of SBJPA and GATT. In the case of changes in the qualification requirements to which section 1465 of SBJPA applies (see the section "Operational Compliance with SBJPA and GATT" below for a discussion of section 1465), the operational compliance requirement of that section must also be satisfied.

Finally, pursuant of section 767(d)(3)(B) of GATT, plans that operate in accordance with the amendments made by that section to section 415(b)(2)(E) shall not be treated as failing to satisfy the section 401(a) qualification requirements or as not being operated in accordance with the provisions of the plan until such date as the Secretary of the Treasury provides merely because the plan has not been amended to include the GATT amendments. In section 7 of Rev. Proc. 97-41, the date provided by the Secretary is the last day of the GATT and SBJPA remedial amendment period, i.e. the last day of the first plan year beginning on or after

January 1, 1999.

Repealing Amendments Under Section 1449(d) of SBJPA

As pointed out earlier in this chapter, GATT made changes to section 415(b)(2)(E) of the Code relating to certain actuarial assumptions used to adjust benefits and limitations when applying the section 415(b) limitations. For those sponsors of pre-GATT plans who had amended their plans before the enactment of SBJPA to reflect the 415(b)(2)(E) changes made by GATT, section 1449 of SBJPA provided them the opportunity to repeal those amendments. SBJPA at section 1449(d) permits an employer with a pre-GATT plan that adopted or made effective an amendment before the enactment date of SBJPA (August 20, 1996) that applied the changes to 415(b)(2)(E) made by GATT, to disregard such amendment when applying the GATT changes, as amended by SBJPA, if the amendment applying the GATT changes, prior to the SBJPA modification, is repealed within one year after the SBJPA enactment date (August 20, 1996).

Section 7 of Rev. Proc. 97-41 extends similar relief to a plan of an employer that adopted an amendment applying the amendments made by section 767 of GATT which was adopted or made effective on or before August 20, 1996. Such amendments will not be taken into account in applying section 767(d)(3)(A) of GATT as amended by section 1449(a) of SBJPA, if the amendment is repealed by another plan amendment that is adopted on or before the last day of the plan's remedial amendment period (the last day of the first year beginning on or after January 1, 1999). Section 7 of Rev. Proc. 97-41 further provides that the relief discussed in that section will not fail to be available merely because a plan is not operated in accordance with the repealing amendment prior to the date specified in future guidance.

Operational Compliance with SBJPA and GATT

Section 6.06 of Rev. Proc. 97-41 provides that, in general, although plan amendments are not required before the end of the remedial amendment period, plan sponsors must operate their plans in compliance with the provisions of SBJPA or GATT prior to the time plan amendments are required to the extent earlier operational compliance is required by law or regulation or by revenue ruling, notice or other guidance published in the Internal Revenue Bulletin. In these cases, any retroactive amendments will have to reflect the choices the plan sponsor has already made in the operation of the plan.

The section 415(b)(2)(E) changes generally must be applied to all benefits under the plan on and after the RPA '94 section 415 effective date, or, if later, the date the plan becomes effective. However, under section 767(d)(3)(A) of RPA '94, as amended by section 1449(a) of SBJPA, a plan adopted and in effect before December 8, 1994, **may** provide that the section 415(b)(2)(E) changes do not apply with respect to benefits accrued before the earlier of (i) the later of the date a plan amendment applying the section 415(b)(2)(E) changes is adopted or made effective, or (ii) the first day of the first limitation year beginning after December 31, 1999 (i.e., accrued before the "final implementation date").

Q&A-18 of Rev. Rul. 98-1 clarifies that a plan amendment to apply the section 415(b)(2)(E) changes need not conform the terms of the plan to the plan's operation prior to the date the plan is amended. An employer may amend its plan within the extended remedial amendment period (the last day of the first plan year beginning on or after January 1, 1999) to apply the section 415(b)(2)(E) changes in a manner permitted under Rev. Rul. 98-1, regardless of whether the amendment is consistent with the plan's operation prior to the date the plan is amended. However, the remedial amendment period is available only if, in accordance with section 401(b) and the regulations thereunder, all of the provisions of the plan needed to satisfy the qualification requirements are in effect by the end of the remedial amendment period and have been made effective for all purposes for the entire period (that is, beginning with the GATT section 415 effective date, plan years and limitation years beginning after 12/31/94). Thus, plan operations (including prior distributions from the plan) must be changed to the extent necessary to conform the operations retroactively to the terms of the plan as retroactively amended for the section 415(b)(2)(E) changes.

SUMMARY

In this lesson, general topics under IRC sections 415(b), 415(c) and 415(e) have been reviewed, with changes affecting section 415 under GATT, SBJPA, and the Taxpayer Relief Act of 1997 highlighted and illustrated through examples. Employers, limitation year, and compensation used for purposes of IRC section 415 have been discussed, as well as adjustments to benefits and limitations under section 415(b), and limitations under section 415(e).