Internal Revenue
bulletin

Bulletin No. 2001–38
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HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 2001–40, page 276.
Refund or credit of an overassessed tax. This ruling modifies Rev. Rul. 78–127 (1978–1 C.B. 436) by clarifying when the Service allows a refund or credit of an overassessed tax. Rev. Rul. 78–127 modified.

EMPLOYEE PLANS

Notice 2001–56, page 277.
EGTRRA effective dates; compensation limit; top-heavy determination date; section 401(k) hardship distribution. This notice provides guidance relating to the effective dates for sections of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) relating to (1) the increase in the compensation limit of section 401(a)(17) of the Code, (2) the modification to the top-heavy rules of section 416 of the Code, and (3) the suspension period for hardship distributions from a section 401(k) plan. Notice 98–52 modified.

Notice 2001–57, page 279.
Qualified plans; sample EGTRRA plan amendments. This notice sets forth various sample amendments that may be adopted by qualified plan sponsors as "good faith" plan amendments to reflect certain changes made by the Economic Growth Tax Relief and Reconciliation Act of 2001 (EGTRRA). Notice 2001–42 modified.

EMPLOYMENT TAX

Rev. Rul. 2001–40, page 276.
Refund or credit of an overassessed tax. This ruling modifies Rev. Rul. 78–127 (1978–1 C.B. 436) by clarifying when the Service allows a refund or credit of an overassessed tax. Rev. Rul. 78–127 modified.

EXEMPT ORGANIZATIONS

Announcement 2001–89, page 291.
A list is provided of organizations now classified as private foundations.

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

Part III. Administrative, Procedural, and Miscellaneous

Effective Dates for Certain Amendments Made by the Economic Growth and Tax Relief Reconciliation Act of 2001

Notice 2001–56

I. Purpose

This notice provides guidance relating to the effective dates for §§ 611(c), 613, and 636(a) of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. 107–16. Section 611(c) of EGTRRA increases the compensation limit of § 401(a)(17) of the Internal Revenue Code (Code) and related sections. Section 613 of EGTRRA modifies the rules in § 416 of the Code regarding determination of top-heavy status. Section 636(a) of EGTRRA directs the Secretary to revise the regulations relating to hardship distributions under § 401(k)(2)(B)(i)(IV) of the Code.

Notice 2001–42 (2001–30 I.R.B. 70), provides a remedial amendment period for EGTRRA, in which any needed retroactive remedial EGTRRA plan amendments may be adopted. The availability of the EGTRRA remedial amendment period is conditioned on the timely adoption of required good faith EGTRRA plan amendments. See Notice 2001–57, page 279, this bulletin, for sample good faith amendments. Although a good faith plan amendment need not reflect all guidance issued under EGTRRA, the plan's operation must be consistent with that guidance, beginning with the effective date of that guidance.

II. Compensation Limit under § 401(a)(17)

A. Background

Section 401(a)(17) of the Code limits the annual compensation that may be taken into account for purposes of determining a participant's benefit accruals under a defined benefit plan or a participant's allocations under a defined contribution plan. Section 401(a)(17) also limits the annual compensation that may be taken into account for purposes of certain nondiscrimination requirements, including those in §§ 401(a)(4), 401(a)(5), 401(l), 401(k), 401(m), 403(b)(12), 404(a)(2), and 410(b)(2), and for purposes of determining whether a definition of compensation is nondiscriminatory under § 414(s)(3). Under § 401(a)(17) as in effect prior to the effective date of the EGTRRA amendment, the compensation limit is $150,000, indexed in $10,000 increments for cost-of-living adjustments. For 2001, the compensation limit is $170,000. A higher compensation limit applies to eligible participants in certain governmental plans. See Treas. Reg. § 1.401(a)(17)–1(d)(4)(ii).

Section 611(c) of EGTRRA amended § 401(a)(17) of the Code by increasing the $150,000 limit (as adjusted) to $200,000, and changing the method used for cost-of-living adjustments. Section 611(c) of EGTRRA made similar amendments to §§ 404(l), 408(k), and 505(b)(7) of the Code.

B. Effective Date

Section 611(i)(1) of EGTRRA provides that the increase in the compensation limit of § 401(a)(17) of the Code applies to years beginning after December 31, 2001. Thus, for purposes of determining benefit accruals or the amount of allocations for plan years beginning on or after January 1, 2002, compensation taken into account may not exceed the compensation limit under § 401(a)(17), as amended by § 611(c) of EGTRRA. In the case of a plan that uses annual compensation for periods prior to the first plan year beginning on or after January 1, 2002, to determine accruals or allocations for a plan year beginning on or after January 1, 2002, the plan is permitted to provide that the $200,000 compensation limit applies to annual compensation for such prior periods in determining such accruals or allocations.

The compensation limit under § 401(a)(17) of the Code is adjusted for cost-of-living increases in accordance with § 401(a)(17)(B), as amended by EGTRRA, as of the beginning of a calendar year. As under pre-EGTRRA law, any such increases shall apply only with respect to annual compensation during the plan year or other 12-month period over which compensation is determined that begins with or within such calendar year (and any subsequent calendar year).

Example. B is a participant in a nongovernmental defined benefit plan, Plan A. Plan A has a calendar plan year, and a benefit formula that provides for an annual benefit at normal retirement age equal to the product of: (years of service) x (1 percent) x (high 3-year average compensation). For this purpose, high 3-year average compensation is the average of the compensation over the 3 consecutive plan years for which the average is the highest, and compensation for each year is limited to $150,000, as adjusted for cost-of-living increases. As of December 31, 2001, B has 10 years of service and compensation of $250,000 for each of the 3 years 1999, 2000, and 2001. B's high 3-year average compensation of $166,667 is determined as the average of annual compensation (as limited by § 401(a)(17) of the Code) of $160,000 for 1999, $170,000 for 2000, and $170,000 for 2001. B's annual benefit under the plan formula as of December 31, 2001, is $16,667, calculated as (10) x (.01) x ($166,667).

In 2002, Plan A is amended (1) to use the $200,000 compensation limit for compensation paid in years beginning after December 31, 2001, and (2) to use the $200,000 compensation limit for compensation paid in years beginning prior to January 1, 2002, in determining benefit accruals in years beginning after December 31, 2001. B has annual compensation of $250,000 for 2002. A high 3-year average compensation of $200,000 is determined for B as of December 31, 2002, as the average of annual compensation (as limited by § 401(a)(17) of the Code, as amended by EGTRRA) of $200,000 for 2000, $200,000 for 2001, and $200,000 for 2002. As of December 31, 2002, B's annual benefit under the plan formula is $22,000, calculated as (11) x (.01) x ($200,000).

Plan A is not required to implement the EGTRRA increase in the compensation limit under § 401(a)(17) of the Code in its benefit formula. Plan A could retain the compensation limit in effect prior to EGTRRA, or provide for any other compensation limit that is less than the compensation limit as amended by EGTRRA. Accordingly, Plan A could be amended to provide that the increased compensation limit applies only to annual compensation paid in plan years beginning on or after January 1, 2002. In that case, a high 3-year average compensation of $180,000 would be determined for B as of December 31, 2002, as the average of annual compensation of $170,000 for 2000 and $170,000 for 2001 (both as limited by § 401(a)(17) of the Code, as in effect prior to amendment by EGTRRA), and $200,000 for 2002 (as limited by § 401(a)(17) of the Code, as amended by EGTRRA). B's annual benefit as of December 31, 2002, would be $19,800, calculated as (11) x (.01) x ($180,000).

III. Determination of Top-Heavy Status under § 416

A. Background

Section 416(a) of the Code provides that a plan that is a top-heavy plan for a plan year must satisfy the vesting and minimum benefit requirements of § 416(b) and (c) for the plan year. A defined benefit plan is a top-heavy plan for a plan year if, as of the determination date, the present value of the cumulative accrued benefits under the plan for key employees exceeds 60 percent of the present value of the cumulative accrued benefits under the plan for all employees. A defined contribution plan is a top-heavy plan for a plan year if, as of the determination date, the aggregate of the accounts of key employees under the plan exceeds 60 percent of the aggregate of the accounts of all employees under the plan. The determination date with respect to any plan year is the last day of the preceding plan year or, in the case of the first plan year of a plan, the last day of such plan year. The determination of whether a plan is top-heavy is made in accordance with the requirements of § 416(g) (including the aggregation requirements of § 416(g)(2)).

Section 613 of EGTRRA amended several provisions of § 416 of the Code, including provisions related to the requirements for determining whether a plan is a top-heavy plan for a plan year. Section 613(a) of EGTRRA modified the definition of "key employee" in § 416(i)(1) of the Code by increasing the compensation threshold for determining when officers are key employees to $130,000 and by eliminating the ten employees owning the largest interests in the employer as a separate category of key employees. Section 613(c) of EGTRRA also provides that the determination of key employee status is made based on the plan year ending on the determination date, thereby eliminating the additional 4-year lookback period for determining key employee status. In general, § 613(c) of EGTRRA modified §§ 416(g)(3) and 416(g)(4)(E) of the Code to exclude from the determination of top-heavy status (1) distributions made prior to the 1-year period ending on the determination date (except that a 5-year period is retained for in-service distributions) and (2) the accrued benefits and account balances of employees who performed no service for the employer during the 1-year period ending on the determination date.

B. Effective Date

Section 613(f) of EGTRRA provides that the amendments made by § 613 apply to years beginning after December 31, 2001. Thus, the EGTRRA amendments to § 416 of the Code apply for purposes of determining whether a plan is top-heavy for the first plan year beginning after December 31, 2001, even though the determination date for that plan year is before the effective date of the EGTRRA amendment.

Thus, for example, for a plan with a calendar plan year (other than a plan in its first plan year), the determination of whether the plan is top-heavy for the plan year beginning January 1, 2002, is made as of December 31, 2001. This determination is made in accordance with the provisions of § 416 of the Code, as amended by EGTRRA. For example, for purposes of identifying key employees in accordance with § 416(i)(1)(A) of the Code as amended by EGTRRA, officers with annual compensation greater than $130,000 for 2001 are key employees, and the additional 4-year lookback period does not apply for purposes of that determination.

IV. Hardship Distributions

A. Background

Elective deferrals under a qualified cash or deferred arrangement subject to § 401(k) of the Code may not be distributable to participants prior to the occurrence of one of the events specified in § 401(k)(2). One of these events is a hardship of the employee. Treas. Reg. § 1.401(k)–1(d)(2)(i) provides that a distribution is treated as made on account of an employee's hardship if it is made on account of an immediate and heavy financial need and is necessary to satisfy the financial need. Treas. Reg. § 1.401 (k)–1(d)(2)(iv)(B) provides a safe harbor pursuant to which a distribution is deemed necessary to satisfy an immediate and heavy financial need. One of the requirements of the safe harbor is that the employee is prohibited from making elective contributions and employee contributions under the plan and all other plans maintained by the employer for at least 12 months after receipt of the hardship distribution. See Treas. Reg. § 1.401(k) –1(d)(2)(iv)(B)(*4*).

Sections 401(k)(12) and 401(m)(11) of the Code provide design-based safe harbor methods for satisfying the actual deferral percentage (ADP) test contained in § 401(k)(3)(A)(ii) and the actual contribution percentage (ACP) test contained in § 401(m)(2) based on matching contributions that meet certain conditions and that satisfy certain notice requirements. Notice 98–52 (1998–2 C.B. 632), provides that a plan will not fail to satisfy the ADP matching contribution safe harbor merely because an eligible employee's ability to make elective deferrals is suspended for 12 months following a hardship distribution. Notice 98–52 also provides that a plan will not fail to satisfy the ACP matching contribution safe harbor merely because an eligible employee's ability to make elective deferrals and employee contributions is suspended for 12 months following a hardship distribution. See Treas. Reg. § 1.401(k)–1(d)(2)(iv)(B)(*4*) and sections V.B.1.c.iv and VI.B of Notice 98–52.

Section 636(a) of EGTRRA directs the Secretary of the Treasury to modify the regulations regarding hardship distributions to provide that the period during which an employee is prohibited from making elective deferrals in order for the distribution to be deemed necessary to satisfy a financial need shall be 6 months (instead of 12 months).

B. Effective Date

Section 636(a) of EGTRRA provides that the regulations as revised in accordance with § 636(a) shall apply to years beginning after December 31, 2001. Thus, the revised regulations will be effective for calendar years beginning after December 31, 2001, rather than effective only with respect to hardship distributions received after December 31, 2001. For example, a plan that provides for hardship distributions in accordance with the safe harbor in Treas. Reg. § 1.401(k) –1(d)(2)(iv)(B) may be amended to provide that an employee who receives a hardship distribution in 2001 is prohibited from making elective deferrals and employee contributions for 6 months after receipt of the distribution (or until Janu-

ary 1, 2002, if later). However, a plan sponsor generally could retain its existing suspension period for all hardship distributions (or for all hardship distributions prior to January 1, 2002).

However, in order to continue to rely on the matching contribution safe harbor in § 401(k)(12) or § 401(m)(11) of the Code to satisfy the ADP or ACP test, a plan must reduce the period during which elective deferrals and employee contributions are suspended following a hardship distribution from 12 months to 6 months for calendar years beginning after December 31, 2001. A plan will not fail to satisfy this requirement merely because it provides that the reduction from 12 months to 6 months applies only to hardship distributions made after December 31, 2001.

V. Effect on Other Documents

Notice 98–52 is modified.

DRAFTING INFORMATION

The principal author of this notice is Ann Trichilo of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone service at (202) 283-9516 or (202) 283-9517, between the hours of 1:30 p.m. and 3:30 p.m. Eastern Time, Monday through Thursday. Ms. Trichilo may be reached at (202) 283-9695. These telephone numbers are not toll-free.

Sample Plan Amendments for the Economic Growth and Tax Relief Reconciliation Act of 2001

Notice 2001–57

I. Purpose

This notice provides sample plan amendments for the changes to the plan qualification requirements under § 401(a) of the Internal Revenue Code that were made by the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107–16 ("EGTRRA"). These sample amendments will help plan sponsors and sponsors and adopters of pre-approved plans comply with the requirement to adopt good faith EGTRRA plan amendments on a timely basis.

In some cases, plan sponsors may be able to adopt the sample amendments verbatim. In other cases, plan sponsors may have to modify the sample amendments to make the amendments appropriate for adoption in their plans.

The sample amendments are examples of plan amendments that satisfy the good faith requirement and should not be viewed as interpretive guidance on the EGTRRA changes to the qualification requirements. Other guidance will address the EGTRRA changes. See, for example, Notice 2001–56, p. 277, this bulletin.

II. Background

EGTRRA. EGTRRA, which was enacted on June 7, 2001, includes numerous changes to the qualified plan rules. Most of these changes are effective in years beginning after December 31, 2001. While many of the changes are not mandatory, a plan sponsor that chooses to implement an optional provision of EGTRRA will have to amend its plan to conform plan provisions to plan operation.

EGTRRA Remedial Amendment Period Requirements. Notice 2001–42 (2001–30 I.R.B. 70) designated as disqualifying provisions under Treas. Reg. § 1.401(b)–1(b) plan provisions that (1) must be amended to satisfy the qualification requirements of the Code because of changes in those requirements made by EGTRRA or (2) are integral to qualification requirements changed by EGTRRA. The effect of this designation is to provide a remedial amendment period under § 401(b), ending no earlier than the end of the 2005 plan year, in which any needed retroactive remedial EGTRRA plan amendments may be adopted (the EGTRRA remedial amendment period).

The availability of the EGTRRA remedial amendment period is conditioned on the timely adoption of required good faith EGTRRA plan amendments. There are two circumstances in which a good faith EGTRRA plan amendment is required. First, a plan is required to have a good faith EGTRRA plan amendment in effect for a year if the plan is required to implement a provision of EGTRRA for the year and the plan language, prior to the amendment, is not consistent with the provision of EGTRRA. Second, a plan is required to have a good faith EGTRRA plan amendment in effect for a year if the plan sponsor elects to implement a provision of EGTRRA for the year and the plan language, prior to the amendment, is not consistent with the operation of the plan in a manner consistent with EGTRRA. A good faith EGTRRA plan amendment is timely if it is adopted no later than the later of (i) the end of the plan year in which the EGTRRA change in the qualification requirements is required to be, or is optionally, put into effect under the plan or (ii) the end of the GUST remedial amendment period for the plan.[1]

Good Faith. A plan amendment is a good faith EGTRRA plan amendment only if the amendment represents a reasonable effort to take into account all of the requirements of the applicable EGTRRA provision and does not reflect an unreasonable or inconsistent interpretation of the provision.

III. Sample EGTRRA Plan Amendments

In General. As provided in Notice 2001–42, the Service is publishing sample EGTRRA plan amendments that can be adopted or used in drafting individualized good faith plan amendments for individually designed and pre-approved plans. In some cases, plan sponsors may be able to adopt the sample amendments in this notice verbatim. In other cases, plan sponsors may have to modify the sample amendments to make them appropriate for adoption in their plans.

The availability of the EGTRRA remedial amendment period is conditioned on the timely adoption of good faith

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

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

Unless section 19 of Rev. Proc. 2000-20, 2000-6 I.R.B. 553, as modified by Notice 2001-42, applies, the GUST remedial amendment period generally ends on the last day of the 2001 plan year.