

Internal Revenue bulletin

Bulletin No. 1998-2
January 12, 1998

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. 98-2, page 15.

Insurance companies; interest rate tables. Prevailing state assumed interest rates are provided for the determination of reserves under section 807 of the Code for contracts issued in 1997 and 1998. Rev. Rul. 92-19 supplemented in part.

Rev. Rul. 98-3, page 4.

Low-income housing credit; satisfactory bond; "bond factor" amounts for the period October through December 1997. This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period October through December 1997. The ruling also corrects errors in the bond factor amounts for properties placed in service in 1987 and disposed of between January through September 1997.

Rev. Rul. 98-4, page 18.

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for January 1998.

EMPLOYEE PLANS

Rev. Rul. 98-1, page 5.

Limitations on benefits and contributions. Questions and answers on the limitations on benefits and contributions under section 415 of the Code, as amended by the Uruguay Round Agreements Act, and taking into account the applicable provisions of the Small Business Job Protection Act of 1996, are set forth.

Rev. Proc. 98-10, page 35.

Minimum funding standards; change in funding method. This procedure provides approval to change the funding method used to determine the minimum funding standard for defined benefit plans for plan years beginning on or after January 1, 1998, to any one of the specific methods contained in this procedure.

Notice 98-2, page 22.

Recovery of basis; retirees. This notice provides a simplified method of calculating the recovery of basis based on the

life of more than one annuitant where the retiree made contributions to a tax-qualified pension plan, even if the amount of the annuity varies by annuitant. The method is described in section 1403 of the Small Business Job Protection Act of 1996 and section 1075 of the Taxpayer Relief Act of 1997.

Notice 98-4, page 25.

Questions and answers; SIMPLE-IRAs, SIMPLE IRA plans. This notice pertains to savings incentive match plans for employees of small employers described in section 408(p) of the Code as added by the Small Business Job Protection Act of 1996, and modified by the Taxpayer Relief Act of 1997.

Announcement 98-1, page 38.

The Service is proposing to include in the Internal Revenue Manual examination guidelines relating to employer deductions to qualified plans under Code section 404 and the minimum funding standards under Code section 412.

EXEMPT ORGANIZATIONS

Announcement 98-3, page 38.

A list is provided of organizations that no longer qualify as organizations for which contributions are deductible under section 170 of the Code.

EXCISE TAX

Rev. Rul. 98-5, page 20.

Bows and arrows; taxable and nontaxable articles. A list of taxable and nontaxable articles is provided for use by manufacturers, producers, and importers in determining their liability for the manufacturers tax on archery equipment imposed by section 4161 of the Code. The list reflects changes to the tax on archery equipment made by the Taxpayer Relief Act of 1997. Rev. Rul. 75-17 supplemented and superseded.

ADMINISTRATIVE

Announcement 98-2, page 38.

New Form 8023, Election Under Section 338 for Corporations Making Qualified Stock Purchases, replaces Form 8023-A, Corporate Qualified Stock Purchases.

Finding Lists begin on page 40.



Department of the Treasury
Internal Revenue Service

Mission of the Service

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our prod-

ucts and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency, and fairness.

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

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 of a permanent nature 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 proce-

dures 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 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.

With the exception of the Notice of Proposed Rulemaking and the disbarment and suspension list included in this part, none of these announcements are consolidated in the Cumulative Bulletins.

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 quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semiannual period, respectively.

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

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 1998. See Rev. Rul. 98-4, page 18.

Low-income housing credit; satisfactory bond; “bond factor” amounts for the period October through December 1997. This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period October through December 1997. The ruling also corrects errors in the bond factor amounts for properties placed in service in 1987 and disposed of between January through September 1997.

Rev. Rul. 98-3

In Rev. Rul. 90-60, 1990-2 C.B. 3, the Internal Revenue Service provided guidance to taxpayers concerning the general

methodology used by the Treasury Department in computing the bond factor amounts used in calculating the amount of bond considered satisfactory by the Secretary under § 42(j)(6) of the Internal Revenue Code. It further announced that the Secretary would publish in the Internal Revenue Bulletin a table of “bond factor” amounts for dispositions occurring during each calendar month.

This revenue ruling provides in Table 1 the bond factor amounts for calculating the amount of bond considered satisfactory under § 42(j)(6) for dispositions of qualified low-income buildings or interests therein during the period October through December 1997. Table 2 provides a summary of the bond factor amounts for dispositions occurring during the period January through September 1997. Table 3 provides a summary of bond factor amounts for dispositions occurring during the period January through December 1996.

Due to a miscalculation, Rev. Rul. 97-16, 1997-13 I.R.B. 4, Rev. Rul. 97-25, 1997-23 I.R.B. 4, and Rev. Rul. 97-34, 1997-34 I.R.B. 4, are in error regarding the specific bond factor amounts for buildings placed in service in calendar year 1987 and disposed of in calendar year 1997. The present revenue ruling provides a complete list of the corrected amounts. Taxpayers who posted bonds prior to the publication date of this revenue ruling based upon the above mentioned bond factor amounts may continue to rely on these figures under the authority of § 7805(b).

For a list of bond factor amounts applicable to dispositions occurring during other calendar years, see the following revenue rulings: Rev. Rul. 90-60, 1990-2 C.B. 3, for dispositions occurring during calendar years 1987, 1988, and 1989;

Rev. Rul. 90-88, 1990-2 C.B. 7, for dispositions occurring during calendar year 1990; Rev. Rul. 91-67, 1991-2 C.B.

Month of Disposition	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year										
	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Oct '97	79.95	79.99	82.52	85.46	88.88	92.76	96.76	100.63	104.47	108.59	112.52
Nov '97	79.95	79.78	82.30	85.23	88.65	92.52	96.51	100.38	104.22	108.38	112.52
Dec '97	79.95	79.57	82.09	85.01	88.42	92.28	96.26	100.13	103.99	108.20	112.52

Month of Disposition	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year										
	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Jan '97	79.95	82.08	84.67	87.70	91.25	95.32	99.53	103.58	107.56	111.85	112.52
Feb '97	79.95	81.83	84.41	87.43	90.96	95.00	99.17	103.18	107.11	111.28	112.52
Mar '97	79.95	81.59	84.15	87.16	90.67	94.69	98.83	102.81	106.69	110.79	112.52
Apr '97	79.95	81.35	83.91	86.90	90.40	94.39	98.50	102.45	106.31	110.36	112.52
May '97	79.95	81.11	83.66	86.64	90.13	94.09	98.18	102.11	105.95	109.98	112.52
Jun '97	79.95	80.88	83.42	86.40	89.87	93.81	97.88	101.79	105.61	109.64	112.52
Jul '97	79.95	80.65	83.19	86.15	89.61	93.54	97.58	101.48	105.30	109.33	112.52
Aug '97	79.95	80.43	82.96	85.92	89.36	93.27	97.30	101.18	105.01	109.06	112.52
Sep '97	79.95	80.21	82.74	85.68	89.12	93.01	97.03	100.90	104.73	108.81	112.52

Table 3
Rev. Rul. 98-3
Monthly Bond Factor Amounts for Dispositions Expressed As a Percentage of Total Credits

Month of Disposition	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year									
	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Jan '96	82.72	85.18	87.85	91.00	94.73	99.06	103.57	107.87	111.88	112.52
Feb '96	82.47	84.92	87.58	90.71	94.42	98.71	103.18	107.41	111.30	112.52
Mar '96	82.22	84.66	87.31	90.43	94.11	98.38	102.80	106.98	110.81	112.52
Apr '96	76.76	78.26	79.91	81.94	84.43	87.38	90.40	93.16	95.61	97.21
May '96	76.54	78.03	79.68	81.71	84.19	87.12	90.12	92.86	95.32	97.21
Jun '96	76.32	77.81	79.46	81.48	83.95	86.86	89.85	92.58	95.06	97.21
Jul '96	81.06	83.47	86.09	89.16	92.78	96.94	101.25	105.33	109.16	112.52
Aug '96	80.84	83.24	85.85	88.92	92.52	96.67	100.96	105.04	108.90	112.52
Sep '96	80.61	83.01	85.62	88.68	92.28	96.41	100.68	104.76	108.66	112.52
Oct '96	80.39	82.78	85.39	88.44	92.03	96.15	100.41	104.49	108.44	112.52
Nov '96	80.17	82.56	85.16	88.21	91.80	95.90	100.16	104.25	108.24	112.52
Dec '96	79.96	82.35	84.95	87.99	91.57	95.67	99.92	104.02	108.06	112.52

13, for dispositions occurring during calendar year 1991;

Rev. Rul. 92-101, 1992-2 C.B. 9, for dispositions occurring during calendar year 1992; Rev. Rul. 93-83, 1993-2 C.B. 6, for dispositions occurring during calendar year 1993;

Rev. Rul. 94-71, 1994-2 C.B. 4, for dispositions occurring during calendar year 1994; and Rev. Rul. 95-83, 1995-2 C.B. 8, for dispositions occurring during calendar year 1995.

DRAFTING INFORMATION

The principal author of this revenue ruling is Jack Malgeri of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. Malgeri at (202) 622-3040 (not a toll-free call).

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of January 1998. See Rev. Rul. 98-4, page 18.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted federal long-term rate is set forth

for the month of January 1998. See Rev. Rul. 98-4, page 18.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 1998. See Rev. Rul. 98-4, page 18.

A revenue procedure describes certain changes to the funding method used to determine the minimum funding standard for defined benefit plans for plan years beginning on or after January 1, 1998. See Rev. Proc. 98-10, page 35.

Section 415. — Limitations on Benefits and Contributions Under Qualified Plans

(Also § 417.)

Limitations on benefits and contributions. Questions and answers on the limitations on benefits and contributions under section 415 of the Code, as amended by the Uruguay Round Agreements Act, and taking into account the applicable provisions of the Small Business Job Protection Act of 1996, are set forth.

Rev. Rul. 98-1

This revenue ruling modifies and supersedes Rev. Rul. 95-29, 1995-1 C.B. 81, which provided questions and an-

swers on the limitations on benefits and contributions under § 415 of the Internal Revenue Code (Code), as amended by the Uruguay Round Agreements Act, Pub. L. No. 103-465 (GATT), which includes the Retirement Protection Act of 1994 (RPA '94). This revenue ruling takes into account the applicable provisions of the Small Business Job Protection Act of 1996, Pub. L. No. 104-188 (SBJPA), after the technical correction made by the Taxpayer Relief Act of 1997, Pub. L. No. 105-34 (TRA '97).

Until further guidance is issued, the guidance provided by these questions and answers may be relied on to administer plans. If, and to the extent, future guidance is more restrictive than the guidance in this revenue ruling, the future guidance will be applied without retroactive effect. No inference should be drawn regarding issues not raised that may be suggested by a particular question and answer or as to why certain questions, and not others, are included.

Background

Section 415 provides that benefits accrued or payable under a qualified defined benefit plan may not exceed certain specified limitations. In general, annual benefits are limited to the lesser of \$90,000, as adjusted for cost-of-living increases (\$130,000 for 1998) and the 10-year phase-in under § 415(b)(5)(A) (the

§ 415(b) dollar limitation), or 100 percent of the participant's average compensation for the participant's high three consecutive years, as adjusted for the 10-year phase-in under § 415(b)(5)(B) (the § 415(b) compensation limitation).

Section 415(b)(2)(B) provides, with certain exceptions, that, if a benefit is payable other than as an annual straight life annuity, the benefit must be actuarially adjusted to an equivalent annual straight life annuity. Sections 415(b)(2)(C) and (D) require that, if a benefit is payable beginning at an age other than the participant's social security retirement age (SSRA), the § 415(b) dollar limitation at that age equals the annual benefit that is actuarially equivalent to the § 415(b) dollar limitation at the participant's SSRA.

Section 415(b)(2)(E) provides rules regarding the actuarial assumptions to be used in making the adjustments required under §§ 415(b)(2)(B), (C), and (D). Section 415(b)(2)(E)(i) generally requires that, for purposes of adjusting any limitation or benefit under § 415(b)(2)(B) or (C), the interest rate assumption shall not be less than the greater of 5 percent or the rate specified in the plan. Section 415(b)(2)(E)(iii) generally requires that, for purposes of adjusting any limitation under § 415(b)(2)(D), the interest rate assumption shall not be greater than the lesser of 5 percent or the rate specified in the plan.

Section 417(e)(3) provides rules regarding the actuarial assumptions to be used to determine the present value of a participant's accrued benefit.

Sections 415(b)(2)(E) and 417(e)(3) of the Code were amended by § 767 of RPA '94. Section 767(a) provided a specific mortality table and changed the applicable interest rate that must be used to determine the present value of a benefit subject to § 417(e)(3) (§ 417(e)(3) changes). Section 767(b) added § 415(b)(2)(E)(v), which requires the mortality table prescribed by the Secretary to be used for adjusting any benefit or limitation under § 415(b)(2). Section 767(b) also revised the interest rates used for adjusting a benefit or limitation in the case of a form of benefit subject to § 417(e)(3) by inserting a new § 415(b)(2)(E)(ii), which required that in such a case the applicable interest rate be substituted for the 5 percent interest rate specified in

§ 415(b)(2)(E)(i).

The amendments made by § 767(b) of RPA '94 were modified by § 1449 of SBJPA. The amendments made by § 1449 of SBJPA are effective as if included in § 767 of RPA '94.

In general, § 1449(a) of SBJPA provides that, in the case of plans adopted and in effect before December 8, 1994, the provisions of § 767(b) shall not be required to be applied with respect to benefits accrued before the later of the date a plan amendment applying the amendments made by § 767(b) is adopted or made effective, but not later than the first day of the first limitation year beginning after 1999. Section 1449(a) further provides that determinations under § 415(b)(2)(E) before such date are made with respect to such benefits on the basis of § 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 § 415 as in effect on December 7, 1994. (Section 1604(b)(3) of TRA '97 deleted superfluous parenthetical language from this rule.) Section 1449(d) of SBJPA provides that if, within one year of the enactment of SBJPA, an amendment made to conform the plan to the requirements of § 767 of RPA '94 is repealed, the original amendment is not taken into account for purposes of applying § 1449(a).

Section 1449(b) of SBJPA amended § 415(b)(2)(E) to provide that in the case of a form of benefit subject to § 417(e)(3), the applicable interest rate is substituted for 5 percent solely for purposes of adjusting the benefit (and not for purposes of adjusting the § 415(b) dollar limitation). Thus, regardless of the form of benefit, the interest rate used to reduce the § 415(b) dollar limitation for benefits payable before SSRA is determined under the rules of § 415(b)(2)(E)(i) (that is, it cannot be less than the greater of 5 percent or the rate specified in the plan).

Section 415(d)(1)(B) provides that the § 415(b) compensation limitation is adjusted annually for cost-of-living increases in the case of participants who have separated from service. Section 732 of GATT changed the periods used to compute increases in the cost of living for purposes of these adjustments.

Rev. Rul. 95-29 provided guidance on limitations on benefits and contributions

under § 415 of the Code, as amended by GATT, including RPA '94. This revenue ruling modifies and supersedes Rev. Rul. 95-29.

Rev. Proc. 97-41, 1997-33 I.R.B. 51, provides guidance to sponsors of plans that are qualified under § 401(a) of the Code with respect to the date by which they must adopt amendments to comply with changes in the law made by GATT and SBJPA.

Questions and Answers

The following terms are used in this revenue ruling:

§ 415(b) compensation limitation. See Background.

§ 415(b) dollar limitation. See Background.

§ 415(b)(2)(E) changes. See Q&A-1.

§ 417(e)(3) changes. See Background.

§ 1449(b) revisions. See Q&A-11.

Age-adjusted dollar limit. See Q&A-7.

Applicable interest rate. See Q&A-4.

Applicable mortality table. See Q&A-6.

Final implementation date. See Q&A-12.

Old-law benefits. See Q&A-12.

Old-law limitations. See Q&A-13.

Participant's freeze date. See Q&A-13.

Plan rate and plan mortality table. See Q&A-7.

Repealing amendment. See Q&A-16.

RPA '94 § 415 effective date. See Q&A-1.

(1) *General Rules and Effective Dates*

Q-1. When are the changes to § 415(b)(2)(E) made by § 767(b) of RPA '94 (§ 415(b)(2)(E) changes) effective?

A-1. Under § 767(d)(1) of RPA '94, the § 415(b)(2)(E) changes are generally effective as of the first day of the first limitation year beginning in 1995, except that an employer may elect to treat the § 415(b)(2)(E) changes as being effective on an earlier date that is on or after December 8, 1994. For purposes of this revenue ruling, the date described in the preceding sentence is the RPA '94 § 415 effective date.

Plan amendments that apply the § 415(b)(2)(E) changes must be effective as of the RPA '94 § 415 effective date. However, § 1449(a) of SBJPA provides a

rule under which the § 415(b)(2)(E) changes are not required to be applied to certain benefits even after the RPA '94 § 415 effective date. See Q&A-12.

Q-2. What plan benefits are subject to the interest rate prescribed by § 415(b)-(2)(E)(ii)?

A-2. The interest rate prescribed by § 415(b)(2)(E)(ii) applies in the case of a form of benefit subject to § 417(e)(3). See § 417(e)(3) and the Income Tax Regulations thereunder to determine whether a form of benefit is subject to § 417(e)(3).

Q-3. Are plans that are not subject to § 417(e)(3) subject to the requirements for assumptions under §§ 415(b)(2)(E)(ii) and (v)?

A-3. Plans that are not subject to § 417(e)(3), such as governmental plans and certain church plans, are not subject to the interest rate requirement under § 415(b)(2)(E)(ii), but are subject to the mortality table requirement under § 415(b)(2)(E)(v).

Q-4. What is the applicable interest rate, as defined in § 417(e)(3), as referenced by § 415(b)(2)(E)(ii)?

A-4. The regulations under § 417(e)(3) (currently § 1.417(e)-1T(d)(3)(i)) provide that the applicable interest rate under § 417(e)(3) is the annual interest rate on 30-year Treasury securities as specified by the Commissioner.

Q-5. What is the time for determining the applicable interest rate?

A-5. A plan that has been amended to reflect the § 417(e)(3) changes must use the same date for determining the applicable interest rate for purposes of applying the § 415(b)(2)(E) changes as it uses for purposes of § 417(e)(3). A plan that has not yet been amended to reflect the § 417(e)(3) changes may use any date for determining the applicable interest rate for purposes of applying the § 415(b)-(2)(E) changes that is permitted under § 417(e)(3) and the regulations thereunder (currently § 1.417(e)-1T(d)-(4)) for use in determining the applicable interest rate for purposes of § 417(e)(3).

Q-6. What mortality table must be used to make adjustments to benefits and limitations under § 415(b)(2)(E)?

A-6. Section 415(b)(2)(E)(v), added by RPA '94, provides that, for purposes of adjusting any benefit or limitation under § 415(b)(2)(B), (C), or (D), the mortality table used shall be the table

prescribed by the Secretary. Rev. Rul. 95-6, 1995-1 C.B. 80, provides the mortality table (applicable mortality table) which generally must be used for these purposes. For purposes of adjusting any limitation under § 415(b)(2)(C) or (D), to the extent that a forfeiture does not occur upon death, the mortality decrement may be ignored prior to age 62 and must be ignored after SSRA. See Q&A G-3 and Q&A G-4 of Notice 83-10, 1983-1 C.B. 536.

Q-7. How are the § 415(b) limitations applied to a benefit under a defined benefit plan that is not payable in the form of an annual straight life annuity within the meaning of § 415(b)(2)(A) and that is not subject to § 417(e)(3)?

A-7. The determination as to whether such a benefit satisfies the § 415(b) limitations generally is made by comparing the equivalent annual benefit determined in Step 1 with the lesser of the age-adjusted dollar limit determined in Step 2 and the § 415(b) compensation limitation determined in Step 3.

Step 1: Under § 415(b)(2)(B), determine the annual benefit in the form of a straight life annuity commencing at the same age that is actuarially equivalent to the plan benefit. In general, §§ 415(b)(2)(E)(i) and (v) require that the equivalent annual benefit be the greater of the equivalent annual benefit computed using the interest rate and mortality table, or tabular factor, specified in the plan for actuarial equivalence for the particular form of benefit payable (plan rate and plan mortality table, or plan tabular factor, respectively) and the equivalent annual benefit computed using a 5 percent interest rate assumption and the applicable mortality table. This step does not apply to a benefit that is not required to be converted to a straight life annuity pursuant to § 415(b)(2)(B) (for example, a qualified joint and survivor annuity).

Step 2: Under § 415(b)(2)(C) or (D), determine the § 415(b) dollar limitation that applies at the age the benefit is payable (age-adjusted dollar limit). The age-adjusted dollar limit is the annual benefit that is actuarially equivalent to an annual benefit equal to the § 415(b) dollar limitation payable at the participant's SSRA.

If the age at which the benefit is payable is 62 or greater, and less than the participant's SSRA, the age-adjusted dol-

lar limit is determined by reducing the § 415(b) dollar limitation at the participant's SSRA using adjustment factors that are consistent with the factors used to reduce old-age insurance benefits under the Social Security Act. Pursuant to Q&A-5 of Notice 87-21, 1987-1 C.B. 458, the § 415(b) dollar limitation at the participant's SSRA is reduced by 5/9 of 1 percent for each of the first 36 months by which benefits commence before the month in which the participant's SSRA is attained and by 5/12 of 1 percent for each additional month.

If the age at which the benefit is payable is less than 62, the age-adjusted dollar limit is determined by reducing the age-adjusted dollar limit at age 62 on an actuarially equivalent basis. In general, §§ 415(b)(2)(E)(i) and (v) require that the reduced age-adjusted dollar limit be the lesser of 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 the amount computed using 5 percent interest and the applicable mortality table (used to the extent described in Q&A-6).

If the age at which the benefit is payable is greater than the participant's SSRA, the age-adjusted dollar limit is determined by increasing the § 415(b) dollar limitation at the participant's SSRA on an actuarially equivalent basis. In general, §§ 415(b)(2)(E)(i) and (v) require that the increased age-adjusted dollar limit be 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 (used to the extent described in Q&A-6).

Step 3: Determine the participant's § 415(b) compensation limitation. This limitation is equal to the participant's compensation averaged over the consecutive three-year period producing the highest average, as provided in § 415(b)(3).

The plan does not satisfy the § 415(b) limitations unless the equivalent annual benefit determined in Step 1 is no greater than the lesser of the age-adjusted dollar limit determined in Step 2 and the § 415(b) compensation limitation determined in Step 3.

Q-8. How is § 415(b)(2)(B) applied to a benefit under a defined benefit plan that is in a form of benefit subject to § 417(e)(3)?

A-8. If a defined benefit plan provides a benefit in a form that is subject to § 417(e)(3), the determination of the equivalent annual benefit is the same as in Q&A-7, Step 1, except that, under § 415(b)(2)(E)(ii), the applicable interest rate is substituted for the 5 percent interest rate under § 415(b)(2)(E)(i). Thus, the equivalent annual benefit must be the greater of the equivalent annual benefit computed using the plan rate and plan mortality table (or plan tabular factor) and the equivalent annual benefit computed using the applicable interest rate and the applicable mortality table.

Example: Plan *A* 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 *A* provides that a participant's single sum is determined as the greater of the present value using 6 percent interest and the UP-1984 Mortality Table and the present value using the applicable interest rate and applicable mortality table. In accordance with § 417(e) and the regulations thereunder, Plan *A* provides that the single sum is not less than the actuarial present value of the normal retirement benefit using the applicable interest rate and the applicable mortality table. The plan has been amended to apply the § 415(b)(2)(E) changes and, in accordance with that amendment, the § 415(b)(2)(E) changes are applied to all accrued benefits for all participants under the plan.

Participant *M*, whose SSRA is age 65, retires at age 60 from Plan *A* and elects to receive a distribution in the form of a single sum. Under the plan formula, and before the application of § 415 under the plan, the amount of the single sum is \$950,000, which is the present value of the early retirement benefit based upon 6 percent interest and the UP-1984 mortality table. This benefit must be converted to an actuarially equivalent straight life annuity commencing at age 60 in order to apply § 415 under the plan. Assuming that the plan's applicable interest rate under § 417(e)(3) is 8 percent, the conversion is made as follows:

First, divide \$950,000 by an immediate straight life annuity purchase rate at age

60 using the plan rate and plan mortality table for determining single sums. Based on 6 percent interest and the UP-1984 Mortality Table, the equivalent annual benefit is \$950,000/10.596, or \$89,656. Second, divide \$950,000 by an immediate straight life annuity purchase rate at age 60 using the applicable interest rate and the applicable mortality table. Based on 8 percent interest and the applicable mortality table, the equivalent annual benefit is \$950,000/10.098, or \$94,078. The equivalent annual benefit for purposes of § 415 is the greater of the two resulting amounts, or \$94,078.

Q-9. How is the age-adjusted dollar limit determined under § 415(b)(2)(C) when a benefit is payable before SSRA in a form subject to § 417(e)(3)?

A-9. If a defined benefit plan provides a form of benefit subject to § 417(e)(3) and the benefit is payable before a participant's SSRA, the age-adjusted dollar limit is determined in the same manner as in Q&A-7, Step 2. Thus, the § 415(b) dollar limitation at the participant's SSRA is reduced by 5/9 of 1 percent for each of the first 36 months by which benefits commence before the month in which the participant's SSRA is attained and by 5/12 of 1 percent for each additional month and, if the age at which the benefit is payable is less than 62, is further reduced in accordance with § 415(b)(2)(E)(i) and (v).

Example: Plan *A* described in Q&A-8 also provides that early retirement annuity benefits are equal to the normal form of annuity benefit payable at age 65, reduced by 4 percent for each year by which the early retirement age is less than 65. Participant *M*'s retirement age is age 60, and Participant *M* has more than 10 years of plan participation at age 60. The age-adjusted dollar limit at age 60 is computed as follows:

The age-adjusted dollar limit at age 62 is determined by reducing the § 415(b) dollar limitation at SSRA (assumed to be \$125,000) by a factor of 5/9 of 1 percent for 36 months. This results in an age-adjusted dollar limit of \$100,000 at age 62, which is further reduced as described below.

First, using the plan tabular factor for early retirement reductions of 4 percent per year, the benefit adjustment factor at age 62 would be 88 percent (100%-(4% x 3)). At age 60, the factor would be 80 percent (100%-(4% x 5)). Accord-

ingly, the actuarially equivalent benefit at age 60 reduced in accordance with plan factors is equal to \$100,000 x 80%/88%, or \$90,909.

Second, even though Participant *M*'s distribution is in the form of a single sum which is subject to § 417(e)(3), the age-adjusted dollar limit at age 62 is now reduced using an interest rate of 5 percent and the applicable mortality table. Assuming no mortality decrement is applied prior to age 62 (which is permitted because plan benefits are not subject to forfeiture upon death prior to the annuity starting date), the actuarially equivalent benefit at age 60 is \$86,661.

The age-adjusted dollar limit at age 60 is the lesser of \$90,909 and \$86,661, or \$86,661. Because the equivalent annual benefit of \$94,078 exceeds the age-adjusted dollar limit at age 60, the single-sum benefit determined in Q&A-8 does not satisfy the § 415(b) limitations.

Q-10. Does a plan amendment that applies the § 415(b)(2)(E) changes violate § 411(d)(6)?

A-10. In general, a plan amendment that changes the interest rate or mortality table taken into account in determining a participant's accrued benefit is subject to the anti-cutback rules under § 411(d)(6) of the Code. However, under § 767(d)(2) of RPA '94, a participant's accrued benefit is not considered to be reduced in violation of § 411(d)(6) merely because the plan is amended to apply the § 415(b)(2)(E) changes. Therefore, a plan amendment that merely applies the § 415(b)(2)(E) changes will not violate § 411(d)(6) even if the amendment applies those changes to previously accrued benefits, including benefits accrued before the RPA '94 § 415 effective date. Similarly, a plan amendment that merely applies the § 415(b)(2)(E) changes will not violate § 411(d)(6) even if the amendment applies those changes to distributions made on or after the RPA '94 § 415 effective date and before the amendment. In addition, an amendment that merely repeals an original § 415(b)(2)(E) amendment, as described in Q&A-16, will be treated as an amendment to apply the § 415(b)(2)(E) changes for purposes of § 767(d)(2) and, therefore, will not violate § 411(d)(6).

Q-11. How is the relief provided under § 767(d)(2) of RPA '94 affected by the retroactive amendment to § 415(b)(2)(E)

made by § 1449(b) of SBJPA (the § 1449(b) revisions)?

A-11. As described in Q&A-10, the § 411(d)(6) relief provided by § 767(d)(2) applies only to the extent that a reduction in accrued benefits results from a plan amendment that merely applies the § 415(b)(2)(E) changes. For this purpose, a plan amendment is considered to apply the § 415(b)(2)(E) changes only if either the plan, as amended, reflects the § 1449(b) revisions for all distributions for periods on and after the RPA '94 § 415 effective date or the plan, as amended, reflects the § 1449(b) revisions for all distributions for periods after August 20, 1996. Thus, the relief under § 767(d)(2) does not apply to a plan amendment that fails to reflect the § 1449(b) revisions for distributions for periods after August 20, 1996. Consequently, a plan that has been amended to apply the § 415(b)(2)(E) changes without regard to the § 1449(b) revisions must be further amended, within the remedial amendment period under § 401(b) for disqualifying provisions under SBJPA and GATT, to reflect the § 1449(b) revisions (that is, it must use the greater of 5 percent and the plan rate in determining the age-adjusted dollar limit for early retirement) for distributions for periods after August 20, 1996. As described in Q&A-18, plan operations must be conformed to the terms of the plan. Accordingly, distributions for periods on or after the RPA '94 § 415 effective date may have to be redetermined.

(2) Transition Rules

Q-12. Must the § 415(b)(2)(E) changes be applied to all benefits under the plan on and after the RPA '94 § 415 effective date?

A-12. The § 415(b)(2)(E) changes generally must be applied to all benefits under the plan on and after the RPA '94 § 415 effective date, or, if later, the date the plan becomes effective. However, under § 767(d)(3)(A) of RPA '94, as amended by § 1449(a) of SBJPA, a plan adopted and in effect before December 8, 1994, may provide that the § 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 § 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. For purposes of this revenue ruling, the date described in the preceding sentence (the earlier of the dates described in (i) and (ii)) is referred to as the final implementation date, and the benefits to which the § 415(b)(2)(E) changes are not applied are referred to as old-law benefits. For purposes of determining the final implementation date, the date in (i) above that a plan amendment applying the § 415(b)(2)(E) changes is made effective is the earliest date as of which, under the amendment, the § 415(b)(2)(E) changes apply to all benefits accruing for the participants under the plan.

Any amendment that provides that the § 415(b)(2)(E) changes will not apply to certain benefits must be adopted prior to the end of the remedial amendment period under § 401(b) for disqualifying provisions under SBJPA and GATT. In addition, except where an employer makes a repealing amendment under Q&A-16, once the final implementation date for a plan resulting from any plan amendment implementing the § 415(b)(2)(E) changes has passed, the extent to which the § 415(b)(2)(E) changes are not applied to certain benefits may not be changed.

Q-13. How is a participant's old-law benefit determined?

A-13. A participant's old-law benefit is determined as of a date specified in the plan for the participant (participant's freeze date) that is before the final implementation date. The plan may provide that the freeze date for all participants is the day before the final implementation date for the plan. Alternatively, the plan may specify 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 § 415 as in effect on December 7, 1994 (old-law limitations), including the participation requirements under § 415(b)(5).

Under the second sentence of § 767(d)(3)(A) of RPA '94 (as amended by SBJPA), before the final implementation date the old-law limitations are applied using all plan terms that were in effect on December 7, 1994 (that is, without regard to amendments made after Decem-

ber 7, 1994) and that are relevant in determining actuarial equivalence under § 415(b)(2)(E). Therefore, except as provided in Q&A-15, in order to determine the old-law benefit, the § 415(b) limitations must be applied using the plan's mortality table as in effect on December 7, 1994 and, except as provided in § 415(b)(2)(D), an interest rate that is no less than the greater of 5 percent or the plan rate as in effect on December 7, 1994 to determine actuarial equivalence. If, as of December 7, 1994, the plan rate for a particular optional form of benefit was a variable interest rate, the plan rate that would be compared to 5 percent is the value of the variable rate at the time the old-law limitations are applied, not the value of the variable rate on December 7, 1994.

Except as provided in Q&A-15, plan amendments that are 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 that become effective under § 415(d) after the participant's freeze date.

Example: Plan B has a calendar plan year and limitation year. N is currently a participant in Plan B and has never participated in any other plan. Plan B is amended on December 1, 1998, to apply the § 415(b)(2)(E) changes. As amended, the plan specifies that the § 415(b)(2)(E) changes will not apply to benefits accrued as of December 31, 1997 (that is, December 31, 1997, is the freeze date for all participants). Thus, any optional form of benefit provided under the plan as of the freeze date (taking into account the old-law limitations) is an old-law benefit. As of December 7, 1994, the plan provides the normal retirement benefit in the form of a straight life annuity beginning at age 65. 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, respectively.

Under the plan, single-sum distributions are available at any permitted retirement age. 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 § 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.

There is no forfeiture of accrued benefits under the plan on account of death prior to the annuity starting date. Under the plan, the § 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 the mortality decrement is ignored prior to age 62.

Participant *N*'s SSRA is 65. As of the freeze date, Participant *N* has 10 years of participation in the plan. Under the plan formula as of *N*'s freeze date, Participant *N*'s accrued benefit payable at normal retirement age (before the application of § 415 under the plan) is \$110,000.

If Participant *N* were to retire in 1999 at age 60 and to elect, with spousal consent, to receive a distribution in the form of a single sum, then Participant *N*'s single-sum distribution at retirement (before the application of § 415 under the plan) would equal the single-sum equivalent of the early retirement annuity benefit under the terms of the plan. Participant *N*'s early retirement benefit accrued as of *N*'s freeze date and payable at age 60, determined using the plan rate and plan mortality table, is \$75,242. Under the plan, the single-sum distribution at age 60 (before the application of § 415 under the plan), which is based on the immediate annuity of \$75,242, the PBGC immediate rate of 6 percent, and the UP-1984 Mortality Table, is \$797,264.

The old-law limitations must now be applied under the plan to determine the old-law benefit for any optional form of benefit elected by *N*. In this case, the plan rate used to determine single sums is the PBGC immediate rate of 6 percent and the plan mortality table is the UP-1984 Mortality Table. The age-adjusted dollar limit at age 60 determined on the basis of § 415(b)(2)(E) as in effect on December

7, 1994 (using 5 percent interest and the UP-1984 Mortality Table) and without taking into account cost-of-living increases under § 415(d) after the freeze date is \$86,143. Because \$75,242 (the annual benefit payable at age 60 that is actuarially equivalent to \$797,264, determined on the basis of § 415(b)(2)(E) as in effect on December 7, 1994) does not exceed \$86,143, the single-sum old-law benefit is \$797,264.

Alternatively, if *N* were to elect to receive a distribution in the form of a straight life annuity commencing at age 60, then the old-law benefit for that optional form would be \$75,242 because that amount does not exceed the age-adjusted dollar limit of \$86,143.

Q-14. How are the § 415(b) limitations applied to a benefit under a defined benefit plan if the § 415(b)(2)(E) changes are not applied to the old-law benefits?

A-14. If the § 415(b)(2)(E) changes are not applied to old-law benefits, the plan can apply the § 415(b) limitations using one of three methods as outlined below. The plan must specify which of the three methods is being used.

Method 1: Under this method, the plan applies the § 415(b) limitations using the steps in Q&A-7, and, if applicable, Q&A-8, except that, if the benefit is not payable in the form of an annual benefit within the meaning of § 415(b)(2)(A), the equivalent annual benefit determined in Step 1 is computed 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 § 415(b)(2)(E) as in effect on December 7, 1994. The determination of the annual benefit that is equivalent to the portion of the plan benefit that is in excess of the old-law benefit must reflect the § 415(b)(2)(E) changes. The results of these two separate computations are added together to determine the equivalent annual benefit, which is then used in the remaining steps in Q&A-7.

In accordance with § 767(d)(3)(A) as amended by SBJPA, if the determination is being made before the final implementation date, then the plan rate and plan mortality table used to determine the annual benefit that is equivalent to the old-

law benefit are based on the plan provisions in effect on December 7, 1994. By contrast, if the determination is being made on or after the final implementation date, then the plan rate and plan mortality table used to determine the annual benefit that is equivalent to the old-law benefit are based on the plan provisions in effect on the date of determination.

In some cases, the use of the applicable mortality table in adjusting the § 415(b) dollar limitation under § 415(b)(2)(C) or (D) can result in an age-adjusted dollar limit lower than the age-adjusted dollar limit used in determining the old-law benefit. A plan using Method 1 may provide that in any event the participant will receive no less than the old-law benefit, limited to the extent required under Q&A-15.

Method 2: Under this method, the plan applies the § 415(b) limitations, using the steps in Q&A-7 and, if applicable, Q&A-8, 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.

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

The following examples illustrate the application of Method 1, Method 2, and Method 3, respectively, of this Q&A-14.

Example 1: The facts with respect to Plan *B* and Participant *N* are as described in the example under Q&A-13. In addition, before applying § 415 under the plan, *N*'s total single-sum benefit payable at age 60 under Plan *B* is \$950,000. This amount is the present value of *N*'s straight life annuity benefit commencing under Plan *B* at age 60 and computed using the PBGC immediate rate of 6 percent and UP-1984 Mortality Table. The applicable interest rate under § 417(e)(3) and Plan *B* is 8 percent.

Plan *B* provides that the § 415(b)(2)(E) changes will not apply to benefits accrued through December 31, 1997, in accordance with Method 1. In addition, as allowed by Method 1, Plan *B* provides that in any event a participant will receive no less than the benefits accrued through December 31, 1997, limited to the extent required under Q&A-15.

Under Plan B's terms, the § 415(b) limitations are applied to N's benefit using the steps in Q&A-7 (as modified in accordance with Q&A-8 for distributions subject to § 417(e)(3)), except that the equivalent annual benefit determined in accordance with Step 1 of Q&A-7 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, and these two amounts are added together to determine N's total equivalent annual benefit.

First, the annual benefit payable at age 60 that is actuarially equivalent to N's single-sum old-law benefit of \$797,264 is determined on the basis of § 415(b)(2)(E) as in effect on December 7, 1994. If the determination were before the final implementation date, all plan terms in effect on December 7, 1994 that are relevant in determining actuarial equivalence under § 415(b)(2)(E) would be used. In this case, the § 415(b)(2)(E) changes apply to benefits accruing for all participants under the plan on and after January 1, 1998. Consequently, the date the plan amendment applying § 415(b)(2)(E) changes is made effective (within the meaning of Q&A-12) is January 1, 1998, and the final implementation date (based on the later of the date the plan amendment is adopted or made effective) is December 1, 1998.

Because the determination is being made in 1999, which is on or after the final implementation date, 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. However, in this case there have been no amendments after December 7, 1994, and the interest rate used for purposes of this adjustment is the greater of the plan rate for determining single sums (6 percent) or 5 percent. The mortality table used is the plan mortality table for determining single sums (UP-1984 Mortality Table). The equivalent annual benefit is \$75,242.

Next, the annual benefit payable at age 60 that is actuarially equivalent to the portion of N's total single-sum benefit of \$950,000 that exceeds \$797,264, or \$152,736, is determined taking into account the § 415(b)(2)(E) changes. For

this purpose, \$152,736 is first converted to an equivalent annual benefit using the plan rate (6 percent) and the plan mortality table (UP-1984 Mortality Table). On this basis, the equivalent annual benefit is \$14,415. The additional \$152,736 is also converted to an equivalent annual benefit using the applicable interest rate (8 percent) and the applicable mortality table. On this basis, the equivalent annual benefit is \$15,125. Under Plan B, the annual benefit that is equivalent to \$152,736 for purposes of § 415 is the greater of \$14,415 and \$15,125, or \$15,125. Thus, the annual benefit that is equivalent to the total single sum of \$950,000 for purposes of § 415 is \$15,125 plus \$75,242, or \$90,367.

Next, the age-adjusted dollar limit at age 60 is determined taking the § 415(b)(2)(E) changes into account. Assuming that the § 415(b) dollar limitation effective for the 1999 calendar year is \$130,000, the age-adjusted dollar limit at age 60 is the lesser of the benefit that is actuarially equivalent to the age-adjusted dollar limit at age 62 (\$104,000) computed using the plan rate and the plan mortality table for making early retirement adjustments (5 percent and UP-1984 Mortality Table, respectively), or \$89,588, and the benefit computed using 5 percent and the applicable mortality table, or \$90,127. Thus, N's age-adjusted dollar limit at age 60 under Plan B is the lesser of \$89,588 and \$90,127, or \$89,588.

Because N's total single-sum benefit is greater than the single-sum old-law benefit and because the equivalent annual benefit (\$90,367) exceeds the age-adjusted dollar limit (\$89,588), N's single-sum benefit under Plan B must be limited to \$942,130 ($\$797,264 + (\$89,588 - \$75,242) \times 10.098$) in order to satisfy the § 415(b) limitations.

Example 2: The facts are the same as in *Example 1*, except that the plan provides that the § 415(b)(2)(E) changes will apply to the total plan benefit, but that in any event the participant will receive no less than the old-law benefit, limited to the extent provided in Q&A-15, in accordance with Method 2.

Under Plan B's terms, the § 415(b) limitations are applied to N's benefit using the steps in Q&A-7 (as modified in accordance with Q&A-8 for distributions

subject to § 417(e)(3)). Thus, the \$950,000 single-sum benefit is first converted to an equivalent annual benefit using the plan rate and plan mortality table for determining single sums (6 percent and UP-1984 Mortality Table, respectively). On this basis, the equivalent annual benefit is \$89,656. The \$950,000 single-sum benefit is then converted to an equivalent annual benefit using the applicable interest rate (8 percent) and the applicable mortality table. On this basis, the equivalent annual benefit is \$94,078. Under Plan B, the annual benefit that is equivalent to \$950,000 for purposes of § 415 is the greater of these two amounts, or \$94,078.

As derived in *Example 1* above, the age-adjusted dollar limit at age 60 is \$89,588. Because the equivalent annual annuity (\$94,078) exceeds this amount and because the total single-sum benefit exceeds the single-sum old-law benefit, the total single-sum benefit must be limited to \$904,660 ($\$89,588 \times 10.098$) in order to satisfy the § 415(b) limitations.

Example 3: The facts are the same as in *Example 1*, except that the plan provides that, in accordance with Method 3, a benefit is limited only to the extent necessary to satisfy the § 415(b) limitations using either Method 1 or Method 2.

In the case of Participant N, the maximum benefit that satisfies the § 415(b) limitations using Method 1 is \$942,130, and the maximum benefit that satisfies the § 415(b) limitations using Method 2 is \$904,660. Thus, the maximum benefit that satisfies the § 415(b) limitations determined in accordance with Method 3 is \$942,130.

Q-15. Under what circumstances does a participant's old-law benefit change after the participant's freeze date?

A-15. A participant's old-law benefit cannot increase after the participant's freeze date. However, for any date after the participant's freeze date, the participant's old-law benefit must be limited if the old-law limitations as of that later date are less than the old-law benefit determined as of the participant's freeze date. For example, if, after the freeze date, annual additions are credited to a participant's account in an existing defined contribution plan of the same employer for a limitation year beginning before January 1, 2000, increases in that partici-

pant's defined contribution fraction could result in changes in the defined benefit fraction that would require a further limitation of the old-law benefit (depending on the terms of the plans).

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

Finally, the old-law benefit is limited to the extent that the total plan benefit determined before applying § 415 under the plan is smaller than the old-law benefit. This could happen, for example, if the plan is amended to change the interest rate generally used to apply § 417(e)(3) in a way that would reduce a participant's total plan benefit, even if the amendment occurs after the participant's freeze date.

Example 1: As of December 7, 1994, Plan C provided that single-sum distributions were determined using the PBGC interest rates and the UP-1984 Mortality Table. Plan C also provided that, for purposes of computing the § 415(b) limitations, an interest rate equal to the greater of 5 percent or the applicable PBGC interest rate would be used with the UP-1984 Mortality Table. Under Plan C, the § 415(b) limitations are applied only after the otherwise determined benefit has been adjusted for early retirement and for any optional form of benefit.

In order to reflect the § 417(e)(3) changes, Plan C is amended on January 1, 1996, effective as of that date, to substitute the applicable interest rate and the applicable mortality table for the original plan rate and the UP-1984 Mortality Table, respectively, to compute single-sum benefits under the plan. These new provisions are applied to all plan benefits (as determined before applying § 415 under the plan), whether accrued before or after the amendment date.

Plan C is amended July 1, 1999, to apply the § 415(b)(2)(E) changes. Plan C's terms as amended provide that the

§ 415(b)(2)(E) changes will not apply to any benefits accrued under the plan as

of December 31, 1999. Thus, the freeze date for all participants in the plan is December 31, 1999, and the final implementation date for Plan C is January 1, 2000.

Because the January 1, 1996 amendment applying the § 417(e)(3) changes is effective before the freeze date, it will be taken into account in determining plan benefits before applying § 415. However, that amendment will not be taken into account in applying the old-law limitations to determine the old-law benefit until the final implementation date. Accordingly, in order to apply the old-law limitations to determine the old-law benefit before the final implementation date, the interest rate used to convert a single-sum benefit to an actuarially equivalent straight life annuity is the greater of 5 percent and the original plan rate.

Plan amendments made after December 7, 1994, including the January 1, 1996 amendment to use the applicable interest rate in determining equivalent single sums for all accrued benefits, must be taken into account in applying the old-law limitations on or after the final implementation date. Therefore, on or after the final implementation date, in determining the equivalent annual benefit under § 415(b)(2)(B), the interest rate used is the greater of 5 percent and the new plan rate under the amendment (the applicable interest rate). If the new plan rate exceeds the greater of 5 percent and the original plan rate, the old-law benefit, determined as of the freeze date, might exceed the old-law limitations when those limitations are applied on or after the final implementation date. In such a case, the old-law benefit must be further limited in order to ensure that the old-law benefit does not exceed the old-law limitations.

Example 2: The facts are the same as in *Example 1*, except that the freeze date for a Participant P is December 31, 1994. Participant P's benefits are being determined as of December 31, 1996. As a result of the January 1, 1996 amendment, before applying § 415 under the plan, P's total plan benefit as of December 31, 1996 (which includes accruals after the freeze date) is smaller than P's old-law benefit. Therefore, the old-law benefit must be limited so that it does not exceed the total plan benefit. Although, as described in *Example 1*, the January 1, 1996 plan amendment is not taken into account

in applying the old-law limitations until the final implementation date of January 1, 2000, the reduction in the total plan benefit resulting from the January 1, 1996 amendment is taken into account immediately for purposes of determining old-law benefits.

Example 3: As of December 7, 1994, Plan D provided that single-sum benefits were determined using the lesser of 6 percent and the PBGC interest rate, and the UP-1984 Mortality Table. Plan D also provided that for purposes of computing benefit adjustments under § 415, an interest rate equal to the greater of 5 percent and the lesser of 6 percent or the PBGC interest rate would be used with the UP-1984 Mortality Table.

In order to reflect the § 417(e)(3) changes, Plan D is amended on December 1, 1996 to substitute the applicable interest rate and the applicable mortality table for the PBGC interest rate and the UP-1984 Mortality Table, respectively, but only with respect to benefits accruing after December 31, 1996. Plan D is amended July 1, 1999 to apply the § 415(b)(2)(E) changes. Plan D's terms as amended provide that the § 415(b)(2)(E) changes will not apply to any benefits accrued under the plan as of December 31, 1994. Thus, the final implementation date for Plan D is July 1, 1999.

Because the amendment to reflect the § 417(e)(3) changes only applies with respect to benefits accruing after December 1, 1996, it has no effect on the plan rate and plan mortality table used with respect to benefits accrued under Plan D as of the freeze date (December 31, 1994). Thus, even on or after the final implementation date, when the plan rate and plan mortality table must be determined taking into account plan amendments made after December 7, 1994, the plan rate and plan mortality table that are used to apply the old-law limitations will be unaffected by the December 1, 1996 amendment to reflect the § 417(e)(3) changes, and the old-law benefit will not have to be limited because of that amendment.

(3) *Plan Amendments and Operational Compliance Issues*

Q-16. How does an employer apply the transitional rule of § 1449(d) of SBJPA to a plan that was amended on or before August 20, 1996, to apply § 767 of RPA '94?

A-16. Section 1449(d) of SBJPA pro-

vides that, if a plan amendment to apply the § 415(b)(2)(E) changes (original amendment) was adopted or made effective on or before August 20, 1996, the employer could adopt another amendment (repealing amendment) to repeal the original amendment, and the original amendment would not be taken into account in applying § 767(d)(3)(A) of RPA '94 as revised by § 1449(a) of SBJPA. Pursuant to section 7 of Rev. Proc. 97-41, an original amendment is not taken into account in applying § 767(d)(3)(A) of RPA '94 as revised by § 1449(a) of SBJPA if a repealing amendment is adopted on or before the last day of the plan's remedial amendment period under § 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 § 415(b)(2)(E) changes.

Q-17. When must qualified plans be amended to apply the § 415(b)(2)(E) changes?

A-17. Under section 6 of Rev. Proc. 97-41, plan amendments to apply the § 415(b)(2)(E) changes must be adopted by the last day of the plan's remedial amendment period under § 401(b) for disqualifying provisions under SBJPA and GATT. For plans other than governmental plans, section 6 of Rev. Proc. 97-41 extended the remedial amendment period to the last day of the first plan year beginning on or after January 1, 1999. For governmental plans, the remedial amendment period is extended to a later date.

Under section 9 of Rev. Proc. 97-41, if a plan terminates prior to the date amendments otherwise must be adopted, the plan must be amended to conform to the applicable § 415(b)(2)(E) changes in connection with that termination.

Q-18. Must a plan amendment to apply the § 415(b)(2)(E) changes conform the terms of the plan to the plan's operation prior to the date the plan is amended?

A-18. No. Except as discussed below, an employer may amend its plan within the remedial amendment period described in Q&A-17 to apply the § 415(b)(2)(E) changes in any manner permitted under this revenue ruling (including an amendment to provide that the § 415(b)(2)(E) changes will not apply to certain bene-

fits), regardless of whether the amendment is consistent with the plan's operation prior to the date the plan is amended. However, this remedial amendment period is available only if, in accordance with § 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 RPA '94 § 415 effective date). 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 § 415(b)(2)(E) changes, including, for example, plan terms that implement the § 1449(b) revisions under Q&A-11.

The following are examples of plan amendments that apply the § 415(b)(2)(E) changes and their effects on prior distributions.

Example 1: Employer *X* maintains Plan *E*, a qualified defined benefit plan that was adopted and effective on January 1, 1985. The plan year and the limitation year for Plan *E* are the calendar year. In making distributions for periods after January 1, 1995, and before August 20, 1996, Employer *X* applied the § 415(b)(2)(E) changes, but did not reduce a participant's benefit below the participant's accrued benefit as of December 31, 1994.

Plan *E* is amended on December 1, 1999, effective on January 1, 1995, to apply the § 415(b)(2)(E) changes. The amendment further provides that the § 415(b)(2)(E) changes do not apply to any benefits accrued before January 1, 2000, in accordance with Method 2 of Q&A-14. Therefore, the amendment to apply the § 415(b)(2)(E) changes is made effective (within the meaning of Q&A-12) on January 1, 2000, and Plan *E* has a final implementation date of January 1, 2000.

Under § 767(d)(3)(A), determinations under § 415(b)(2)(E) with respect to old-law benefits made before January 1, 2000, are based on § 415(b)(2)(E) and plan terms as in effect on December 7, 1994. Plan operations must be retroactively conformed to the terms of the plan as retroactively amended. Therefore, distributions made from Plan *E* between January 1,

1995 and August 20, 1996 must be redetermined to reflect the freeze date used in the December 1, 1999 amendment.

Example 2: Employer *Y* maintains Plan *F*, a qualified defined benefit plan that was adopted and effective on January 1, 1985. The plan year and the limitation year for Plan *F* are the calendar year. In making distributions for periods after January 1, 1995, including distributions for periods after August 20, 1996, Employer *Y* applied the § 415(b)(2)(E) changes using § 415(b)(2)(E)(ii) as amended by RPA '94, but did not take the § 1449(b) revisions into account.

Plan *F* is amended on November 1, 1999, effective on January 1, 1995, to apply the § 415(b)(2)(E) changes. The amendment provides, that for distributions for periods after January 1, 1995, and on or before August 20, 1996, in the case of a form of benefit subject to § 417(e)(3), the applicable interest rate is substituted for 5 percent in determining the age-adjusted dollar limits. For distributions for periods after August 20, 1996, the amendment reflects the § 1449(b) revisions. In accordance with Method 2 of Q&A-14, the amendment further provides that the benefits of any current or former participant shall not be reduced below the participant's accrued benefit as of December 31, 1994. Therefore, the amendment adopted November 1, 1999 to apply the § 415(b)(2)(E) changes is made effective (within the meaning of Q&A-12) on January 1, 1995, and Plan *F* has a final implementation date of November 1, 1999.

Plan operations (including distributions made from Plan *F* on or after the RPA '94 § 415 effective date) must be retroactively conformed to the terms of the plan as retroactively amended. In this case, distributions from Plan *F* made before the amendment conform to the terms of the plan except to the extent that distributions for periods after August 20, 1996 did not reflect the § 1449(b) revisions. Such distributions will have to be redetermined.

Example 3: Employer *Z* maintains Plan *G*, a qualified defined benefit plan that was adopted and effective on January 1, 1982. The plan year and limitation year are the calendar year. Plan *G* is amended on March 1, 1998, effective on January 1, 1995, to apply the § 415(b)(2)(E) changes. The amendment provides that in

the case of participants who terminate before February 1, 1998, the § 415(b)(2)(E) changes do not apply to benefits accrued before January 1, 1995, in accordance with Method 2 of Q&A-14. The amendment further provides that in the case of participants who have an hour of service on or after February 1, 1998, the § 415(b)(2)(E) changes do not apply to benefits accrued before January 1, 1999, in accordance with Method 1 of Q&A-14. In making distributions since January 1, 1995, Employer Z applied the § 415(b)(2)(E) changes, but did not reduce the participant's benefit below the participant's accrued benefit as of December 31, 1994.

Plan operations (including distributions made from Plan G on or after the RPA '94 § 415 effective date) must be retroactively conformed to apply the plan terms as retroactively amended. In the case of Plan G, distributions made for participants who terminated prior to February 1, 1998, will conform to the terms of the plan (except to the extent a distribution for a period after August 20, 1996 might have reflected § 415(b)(2)(E)(ii), as amended by RPA '94, but before amendment by § 1449(b) of SBJPA).

(4) Plan Funding

Q-19. May the § 415(b)(2)(E) changes be taken into account for purposes of the minimum funding standards under § 412 before the plan is amended to reflect these changes?

A-19. Except as provided under § 412(c)(12) or by the Commissioner, changes in plan benefits that become effective after the first day of the current plan year may not be anticipated for purposes of § 412. See § 1.412(c)(3)-1(d)(1).

In the case of a plan that is operated in accordance with the § 415(b)(2)(E) changes, the anticipation of a plan amendment applying the § 415(b)(2)(E) changes is hereby permitted for purposes of § 412 until the final implementation date. For purposes of the preceding sentence, for plan years beginning before January 1, 1997, the anticipated plan amendment need not reflect the amendments made to § 415 of the Code or § 767 of RPA '94 by § 1449 of SBJPA. For plan years beginning on or after January 1, 1997, a plan

amendment applying the § 415(b)(2)(E) changes may be anticipated only if the plan amendment is permitted under this revenue ruling 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 § 415(b)(2)(E) changes will not apply to participants' old-law benefits (including, if applicable, any freeze date under Q&A-13 and method under Q&A-14). Note that if the § 415(b)(2)(E) changes are retroactively applied to all benefits under the plan, this must be specified in the attachment. In addition, once a Schedule B of Form 5500 is filed for a plan year, the anticipated amendment, if any, that was used in applying § 412 for that year cannot be changed (for purposes of applying § 412 for that year).

If no such attachment is made to Schedule B of Form 5500 for a plan year, the employer may not anticipate the § 415(b)(2)(E) changes for that plan year and must determine the minimum funding standard using the terms of the plan.

Q-20. What are the implications of a plan being funded on the basis of plan terms without taking the § 415(b)(2)(E) changes into account?

A-20. If an employer has not yet amended its plan to reflect the § 415(b)(2)(E) changes, funding on the basis of plan terms could result in a plan being funded based on benefits that exceed the § 415(b) limitations. Because § 404(j) provides that benefits in excess of the § 415(b) limitations may not be taken into account in determining a deduction under § 404, contributions that are made as a result of benefits that are in excess of the § 415 limits are nondeductible, regardless of whether they are required under § 412. Thus, if an employer has not yet amended its plan to apply the § 415(b)(2)(E) changes, the employer could be required to make nondeductible contributions to the plan to satisfy the minimum funding standards, unless (in accordance with Q&A-19) a plan amendment to apply the § 415(b)(2)(E) changes is anticipated.

However, for taxable years relating to plan years beginning prior to January 1, 1997, the Service will not assert a violation of § 404(j) merely because contribu-

tions 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. The preceding sentence 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 § 415(b)(2)(E) changes.

(5) Miscellaneous

Q-21. Are the RPA '94 § 415 effective date and the final implementation date for a plan affected by the date the § 417(e)(3) changes are made effective for the plan?

A-21. No. The RPA '94 § 415 effective date applies regardless of when the § 417(e)(3) changes are made effective for the plan. In addition, the final implementation date for a plan may be different from the date the § 417(e)(3) changes are made effective for the plan.

Q-22. Must a plan provide a uniform freeze date under Q&A-13 and a uniform method under Q&A-14 for all participants?

A-22. No. A plan may provide different participant freeze dates under Q&A-13 or different methods under Q&A-14 for different participants in the plan. In addition, a plan may provide no freeze date for some participants (that is, the § 415(b)(2)(E) changes apply to the entire accrued benefit of those participants), while providing a freeze date for other participants. However, the availability of a specific participant freeze date under Q&A-13 or method described in Q&A-14 is a benefit, right, or feature, which must satisfy the nondiscriminatory availability requirement of § 1.401(a)-(4)-4. Furthermore, in accordance with Q&A-11 of Notice 87-21, if a limitation under § 415 may be applied in more than one manner, the plan must specify the manner in which the limitation is to be applied.

Q-23. Are fully insured plans that meet the accrued benefit requirements of § 411(b) by satisfying the requirements of § 411(b)(1)(F) subject to the new requirements under § 415(b)(2)(E) as amended by RPA '94 and SBJPA?

A-23. Yes, these plans are subject to all of the requirements of § 415.

Q-24. How is the § 415(b) compensation limitation adjusted for years beginning after December 31, 1994?

A-24. Section 415(d)(1)(B) provides that the § 415(b) compensation limitation is adjusted annually for cost-of-living increases in the case of a participant who has separated from service. Section 732(b) of GATT changed the base period for computing the annual adjustments.

For a participant separating from service on or before December 31, 1994, the § 415(b) compensation limitation for the 1995 calendar year is computed by multiplying the participant's compensation limitation, as adjusted under prior law through the 1994 calendar year, by 1.0217.

PAPERWORK REDUCTION ACT

The collection of information contained in this revenue ruling has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1563.

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

The collection of information in this revenue ruling is in Q&A-19. This revenue ruling provides guidance on the limitations on benefits and contributions under § 415 of the Code and § 767 of RPA '94 as amended by § 1449 of SBJPA, including the various options that an employer may elect when implementing the amendment. This information will be used in determining benefits taken into account for purposes of the minimum funding requirements for the plan. The collection of information is required to assure compliance with the minimum funding requirements. The likely respondents are businesses or other for-profit institutions, nonprofit institutions, and small businesses or organizations.

The estimated total annual reporting burden is 35,000 hours.

The estimated annual burden per respondent varies from 15 minutes to 45 minutes, depending on individual circumstances, with an estimated average of 30 minutes. The estimated number of respondents is 70,000.

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

Effect On Other Documents

Rev. Rul. 95-29, 1995-1 C.B. 81, is modified and superseded.

Drafting Information

The principal authors of this revenue ruling are John Heil and Martin Pippins of the Employee Plans Division. For further information regarding this revenue ruling, contact the Employee Plans Division's taxpayer assistance number at (202) 622-6076 (not a toll-free number) between the hours of 2:30 p.m. and 3:30 p.m., Eastern Time, Monday through Thursday. Mr. Heil's telephone number is (202) 622-7383 (also not a toll-free number). Mr. Pippins' telephone number is (202) 622-6261 (also not a toll-free number).

Section 417.—Definitions and Special Rules for Purposes of Minimum Survivor Annuity Requirements

26 CFR 1.417(e)-1: Restrictions and valuations of distributions from plans subject to §§ 401(a)(11) and 417.

Whether the applicable interest rate described in § 417(e)(3) of the Code as applied for purposes of § 415(b)(2)(E) is affected by the Small Business Job Protection Act of 1996, Pub. L. 104-188. See Rev. Rul. 98-1 page 5.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 1998. See Rev. Rul. 98-4, page 18.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 1998. See Rev. Rul. 98-4, page 18.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of January 1998. See Rev. Rul. 98-4, page 18.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 1998. See Rev. Rul. 98-4, page 18.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of January 1998. See Rev. Rul. 98-4, page 18.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 1998. See Rev. Rul. 98-4, page 18.

Insurance companies; interest rate tables. Prevailing state assumed interest rates are provided for the determination of reserves under section 807 of the Code for contracts issued in 1997 and 1998. Rev. Rul. 92-19 supplemented in part.

Rev. Rul. 98-2

For purposes of § 807(d)(4) of the Internal Revenue Code, for taxable years beginning after December 31, 1996, this ruling supplements the schedules of prevailing state assumed interest rates set forth in Rev. Rul. 92-19, 1992-1 C.B. 227. This information is to be used by insurance companies in computing their reserves for (1) life insurance and supplementary total and permanent disability benefits, (2) individual annuities and pure endowments, and (3) group annuities and pure endowments. As § 807(d)(2)(B) requires that the interest rate used to compute these reserves be the greater of (1) the applicable federal interest rate, or (2) the prevailing state assumed interest rate, the table of applicable federal interest rates in Rev. Rul. 92-19 is also supplemented.

Following are supplements to schedules A, B, C, and D to Part III of Rev. Rul.

92-19, providing prevailing state assumed interest rates for insurance products with different features issued in 1997 and 1998, and a supplement to the table in Part IV of Rev. Rul. 92-19, providing the applicable federal interest rate under § 807(d) for

1997 and 1998. This ruling does not supplement Parts I and II of Rev. Rul. 92-19.

This is the sixth supplement to the interest rates provided in Rev. Rul. 92-19. Earlier supplements were published in Rev. Rul. 93-58, 1993-2 C.B. 241 (interest rates

for insurance products issued in 1992 and 1993), Rev. Rul. 94-11, 1994-1 C.B. 196 (1993 and 1994), Rev. Rul. 95-4, 1995-1 C.B. 141 (1994 and 1995), Rev. Rul. 96-2, 1996-1 C.B. 141 (1995 and 1996), and Rev. Rul. 97-2, 1997-1 C.B. 8 (1996 and 1997).

Part III. Prevailing State Assumed Interest Rates — Products Issued in Years After 1982.*

Schedule A

STATUTORY VALUATION INTEREST RATES BASED ON THE
1980 AMENDMENTS TO THE NAIC STANDARD VALUATION LAW

A. Life insurance valuation:

<u>Guarantee Duration</u> (years)	<u>Calendar Year of Issue</u> <u>1998</u>
10 or fewer	5.50**
More than 10 but not more than 20	5.25**
More than 20	4.50**

Source: Rates calculated from the monthly averages, ending June 30, 1997, of Moody's Corporate Bond Yield Average—Monthly Average Corporates.

** As the applicable federal interest rate for 1998 of 6.31 percent exceeds this prevailing state assumed interest rate, the interest rate to be used for this product under § 807 is 6.31 percent.

* The terms used in the schedules in this ruling and in Part III of Rev. Rul. 92-19 are those used in the Standard Valuation Law; the terms are defined in Rev. Rul. 92-19.

Part III, Schedule B

STATUTORY VALUATION INTEREST RATES BASED ON THE
1980 AMENDMENTS TO THE NAIC STANDARD VALUATION LAW

B. Single premium immediate annuities and annuity benefits involving life contingencies arising from other annuities with cash settlement options and from guaranteed interest contracts with cash settlement options:

<u>Calendar Year of Issue</u>	<u>Valuation Interest Rate</u>
1997	6.75*

Source: Rates calculated from the monthly averages, ending June 30, 1997, of Moody's Corporate Bond Yield Average — Monthly Average Corporates. The terms used in this schedule are those used in the Standard Valuation Law as defined in Rev. Rul. 92-19.

As this prevailing state assumed interest rate exceeds the applicable federal interest rate for 1997 of 6.33 percent, the prevailing state assumed interest rate of 6.75 percent is to be used for this product under § 807.

Part III, Schedule C15 - 1997

STATUTORY VALUATION INTEREST RATES BASED ON NAIC STANDARD VALUATION
LAW FOR 1997 CALENDAR YEAR BUSINESS GOVERNED BY THE 1980 AMENDMENTS

C. Valuation interest rates for other annuities and guaranteed interest contracts that are valued on an issue year basis:

<u>Cash Settlement Options?</u>	<u>Future Interest Guarantee?</u>	<u>Guarantee Duration (years)</u>	<u>Valuation Interest Rate For Plan Type</u>			
			<u>A</u>	<u>B</u>	<u>C</u>	
Yes	Yes	5 or fewer	6.75	5.75*	5.25*	
		More than 5, but not more than 10	6.50	5.75*	5.25*	
		More than 10, but not more than 20	6.00*	5.25*	5.25*	
		More than 20	5.25*	4.75*	4.75*	
Yes	No	5 or fewer	7.00	6.00*	5.50*	
		More than 5, but not more than 10	6.75	6.00*	5.50*	
		More than 10, but not more than 20	6.25*	5.50*	5.25*	
		More than 20	5.25*	5.00*	5.00*	
No	Yes or No	5 or fewer	6.75			
		More than 5, but not more than 10	6.50			
				NOT APPLICABLE		
		More than 10, but not more than 20	6.00*			
		More than 20	5.25*			

Source: Rates calculated from the monthly averages, ending June 30, 1997 of Moody's Corporate Bond Yield Average—Monthly Average Corporates.

*As the applicable federal interest rate for 1997 of 6.33 percent exceeds this prevailing state assumed interest rate, the interest rate to be used for this product under § 807 is 6.33 percent.

Part III, Schedule D15—1997

STATUTORY VALUATION INTEREST RATES BASED ON NAIC STANDARD
VALUATION LAW FOR 1997 CALENDAR YEAR BUSINESS GOVERNED BY THE 1980 AMENDMENTS

D. Valuation interest rates for other annuities and guaranteed interest contracts that are contracts with cash settlement options and that are valued on a change in fund basis:

<u>Cash Settlement Options?</u>	<u>Future Interest Guarantee?</u>	<u>Guarantee Duration (years)</u>	<u>Valuation Interest Rate For Plan Type</u>		
			<u>A</u>	<u>B</u>	<u>C</u>
Yes	Yes	5 or fewer	7.50	7.00	5.50*
		More than 5, but not more than 10	7.25	7.00	5.50*
		More than 10, but not more than 20	6.75	6.50	5.25*
		More than 20	5.75*	5.75*	5.00*
Yes	No	5 or fewer	7.75	7.25	5.75*
		More than 5, but not more than 10	7.50	7.25	5.75*
		More than 10, but not more than 20	7.00	6.75	5.50*
		More than 20	6.00*	6.00*	5.25*

Source: Rates calculated from the monthly averages, ending June 30, 1997, of Moody's Corporate Bond Yield Average—Monthly Average Corporates.

*As the applicable federal interest rate for 1997 of 6.33 percent exceeds this prevailing state assumed interest rate, the interest rate to be used for this product under § 807 is 6.33 percent.

Part IV. Applicable Federal Interest Rates.

TABLE OF APPLICABLE FEDERAL INTEREST RATES FOR PURPOSES OF § 807

<i>Year</i>	<i>Interest Rate</i>
1997	6.33
1998	6.31

Sources: Rev. Rul. 96-57, 1996-2 C.B. 82 for the 1997 rate and Rev. Rul. 97-50, 1997-49 I.R.B. 5 for the 1998 rate.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 92-19 is supplemented by the addition to Part III of that ruling of prevailing state assumed interest rates under § 807 for certain insurance products issued in 1997 and 1998 and is further supplemented by an addition to the table in Part IV of Rev. Rul. 92-19 listing applicable federal interest rates. Parts I and II of Rev. Rul. 92-19 are not affected by this ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Ann H. Logan of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling contact her on (202) 622-3970 (not a toll-free call).

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-

term, and long-term rates are set forth for the month of January 1998. See Rev. Rul. 98-4, on this page.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for January 1998.

Rev. Rul. 98-4

This revenue ruling provides various prescribed rates for federal income tax purposes for January 1998 (the current month.) Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for

purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520. Finally, Table 6 contains the deemed rate of return for transfers made during calendar year 1998 to pooled income funds described in § 642(c)(5) that have been in existence for less than 3 taxable years immediately preceding the taxable year in which the transfer is made.

REV. RUL. 98-4 TABLE 1				
Applicable Federal Rates (AFR) for January 1998				
	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
<i>Short-Term</i>				
AFR	5.70%	5.62%	5.58%	5.56%
110% AFR	6.28%	6.18%	6.13%	6.10%
120% AFR	6.85%	6.74%	6.68%	6.65%
130% AFR	7.44%	7.31%	7.24%	7.20%
<i>Mid-Term</i>				
AFR	5.93%	5.84%	5.80%	5.77%
110% AFR	6.52%	6.42%	6.37%	6.34%
120% AFR	7.13%	7.01%	6.95%	6.91%
130% AFR	7.73%	7.59%	7.52%	7.47%
150% AFR	8.95%	8.76%	8.67%	8.60%
175% AFR	10.48%	10.22%	10.09%	10.01%

REV. RUL. 98-4 TABLE 1 — (continued)
Applicable Federal Rates (AFR) for January 1998

	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
<i>Long-Term</i>				
AFR	6.13%	6.04%	6.00%	5.97%
110% AFR	6.75%	6.64%	6.59%	6.55%
20% AFR	7.38%	7.25%	7.19%	7.14%
130% AFR	8.00%	7.85%	7.77%	7.72%

REV. RUL. 98-4 TABLE 2
Adjusted AFR for January 1998

	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
Short-term adjusted AFR	3.86%	3.82%	3.80%	3.79%
Mid-term adjusted AFR	4.30%	4.25%	4.23%	4.21%
Long-term adjusted AFR	5.10%	5.04%	5.01%	4.99%

REV. RUL. 98-4 TABLE 3
Rates Under Section 382 for January 1998

Adjusted federal long-term rate for the current month	5.10%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	5.23%

REV. RUL. 98-4 TABLE 4
Appropriate Percentages Under Section 42(b)(2) for January 1998

Appropriate percentage for the 70% present value low-income housing credit	8.41%
Appropriate percentage for the 30% present value low-income housing credit	3.61%

REV. RUL. 98-4 TABLE 5
Rate Under Section 7520 for January 1998

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	7.2%
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REV. RUL. 98-4 TABLE 6
Deemed Rate for Transfers to New Pooled Income Funds

Deemed rate of return for transfers during 1998 to pooled income funds that have been in existence for less than 3 taxable years	7.2%
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Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 1998. See Rev. Rul. 98-4, page 18.

Section 4161.—Imposition of Tax

26 CFR 48.4161(b)-1: *Imposition and rates of tax; bows and arrows.*

Bows and arrows; taxable and nontaxable articles. An illustrative list of taxable and nontaxable articles is provided for use by manufacturers, producers, and importers in determining their liability for the manufacturers tax on archery equipment imposed by section 4161 of the Code. The list reflects changes to the tax on archery equipment made by the Taxpayer Relief Act of 1997. Rev. Rul 75-17 supplemented and superseded.

Rev. Rul. 98-5

This revenue ruling updates Rev. Rul. 75-17, 1975-1 C.B. 344, by revising the illustrative list of taxable and nontaxable archery articles in that ruling. This revenue ruling provides guidance to manufacturers, producers, and importers in determining their liability for the manufacturers excise tax on bows and arrows imposed by § 4161(b) of the Internal Revenue Code.

BACKGROUND

For sales prior to October 1, 1997, § 4161(b) imposed an 11 percent tax on the sale by the manufacturer, producer, or importer of any bow that had a draw weight of 10 pounds or more, any arrow that measured 18 inches or more in overall length, or any arrow sold after September 30, 1984, that measured less than 18 inches in overall length but was suitable for use with a taxable bow, any part or accessory suitable for inclusion in or attachment to a taxable bow or arrow, and any quiver suitable for use with taxable arrows.

For sales after September 30, 1997, § 4161(b), as amended by § 1433(a) of the Taxpayer Relief Act of 1997 (TRA-97), provides for the continued taxation of bows, bow parts and accessories, and quivers in the same manner and at the same rate as before amendment. However, § 4161(b), as amended, replaces the prior tax on arrows

and arrow parts and accessories with an excise tax on arrow components. The new tax is imposed at the rate of 12.4 percent on the sale by the manufacturer, producer, or importer of arrow components. For this purpose, an arrow component is any shaft, point,nock, or vane of the type used in the manufacture of any arrow which after its assembly (A) measures 18 inches or more in overall length, or (B) measures less than 18 inches in overall length, but is suitable for use with a taxable bow.

No tax is imposed under the former or amended § 4161(b) with respect to any article taxable under § 4161(a) as sport fishing equipment, for example, bow fishing rods and reels.

Section 48.4161(b)-2(a)(1) of the Manufacturers and Retailers Excise Tax Regulations defines the term “bows” as including all articles made of flexible materials that are designed to be equipped with a string and used for the propelling of arrows in the sport of archery (target shooting), or in hunting or fishing.

Section 48.4161(b)-2(a)(2) defines the term “arrows” as including all articles designed or constructed to be propelled by a bow in the sport of archery (target shooting), or in hunting or fishing. The overall length of the arrow is to be measured from the point of the tip or arrowhead to the end of the arrow nock. In the case of arrows sold by the manufacturer without heads, tips, or nocks, the overall length is to include the length of the shaft plus the length of the nock and head or tip that is normally used with the particular type of arrow shaft.

(The following provisions of the regulations do not reflect the amendments made to § 4161(b) by the TRA-97.)

Section 48.4161(b)-2(b)(1) defines the term “parts and accessories” for bows and arrows as including all articles (other than fishing reels) suitable for inclusion in or attachment to a taxable bow or arrow. Examples of parts and accessories for bows are bow handles, bow limbs, bowstrings, bowstring silencers, bow stabilizers, arrow rests, bow slings, bow sights, bow levels, bow tip protectors, brush buttons, camouflaged bow covers, and all other articles designed to be attached to or included in a bow to assist in aiming or propelling an arrow, or to protect the bow while in use. Examples of parts and accessories for arrows are arrow shafts, nocks, tips, heads, head adapters, and feathers.

Under the provisions of § 48.4161(b)-2(b)(2), general purpose materials and arti-

cles that are not specifically designed to directly improve the performance or appearance of bows or arrows, or to protect them while in use, are not considered to be parts and accessories for bows or arrows, even though such materials may be intended, after further processing, to be included in or attached to bows or arrows. An example of a nontaxable article that is designed for use with a bow, but is neither attached to a bow, nor serves a purpose directly related to the efficient use of a bow, is a carrying case for a bow. Examples of nontaxable general purpose materials or articles are glues and cements, feathers before they are prepared for use with arrows, and bowstring thread before it is processed into bowstrings. Arrow shaft material is considered to be a taxable part for an arrow unless the manufacturer, producer, or importer can establish that the particular material is unsuitable for use in the manufacture of taxable arrows. In addition, the term parts and accessories does not include articles in the nature of expendable supplies, even though such articles are designed to be applied to, or used with, bows or arrows. Examples of such supply materials are bowstring wax and archery powder.

Section 48.4161(b)-2(c) defines the term “quivers” as including all articles, of whatever material made, that are designed to contain, and to provide ready access to, taxable arrows during the time an archer is engaged in target shooting, hunting, or fishing. The term does not include any article designed solely for storing or transporting arrows during times when the arrows are not in use.

ILLUSTRATIVE LISTS

The Internal Revenue Service has determined that the articles listed below are bows, arrows, arrow components, or parts or accessories subject to the tax imposed by § 4161(b). The parts or accessories subject to the tax include replacement parts or accessories. A separate list of the articles that the Service has determined not to be subject to the tax imposed by that section is also provided. The lists are illustrative and not all-inclusive.

ARTICLES SUBJECT TO TAX

Bows

All bows that have a draw weight of 10 pounds or more, including laminated composite bows; solid glass, wood, steel, etc., bows; and crossbows.

Arrows

(Prior to October 1, 1997)

All arrows (including bow fishing arrows), regardless of shaft material or the type of head, that measure 18 inches or more in overall length (including the tip or head, and nock), and all arrows sold after September 30, 1984, that measure less than 18 inches in overall length but are suitable for use with a taxable bow.

Arrow Components

(After September 30, 1997)

All shafts, points, nocks, or vanes of the type used in the manufacture of any arrow which after its assembly (A) measures 18 inches or more overall in length, or (B) measures less than 18 inches overall in length, but is suitable for use with a taxable bow.

Bow and Arrow Sets

Bow and arrow sets that contain any taxable article. When a set also contains nontaxable articles, the tax applies only to that portion of the combination sale price properly attributable to the taxable articles. See Rev. Rul. 75-18, 1975-1 C.B. 345, which provides a method of determining the manufacturer's tax base and computing the tax where taxable and nontaxable articles are sold as a unit at a single price.

Bow Parts and Accessories and Quivers
Arrow holders (all items to be affixed to a bow to hold an arrow in ready position)
Arrow plates (whether fixed, adjustable, spring loaded, etc.)
Arrow rests (whether bow shelf or auxiliary type)
Bow handles
Bow handle sections
Bow levels
Bow limbs
Bow saddles (including interchangeable or replaceable bow grips)
Bow sights and bow sight extensions (including parts and attachments therefor)
Bow silencing pads
Bow slings
Bow stabilizers (all attachments and weights for use on bows to affect stabilization, counterbalancing, or modification of weight distribution)
Bowstrings
Bowstring silencers
Bow tip protectors
Brush buttons
Cable guards
Cable guard slides

Camouflaged bow covers (slip-over cloth, self-adhesive tape type, etc.)

Cushion nocks

Draw checks (spring loaded clickers, mirrors, or any other device attached to a bow or string to insure consistent draw length)

Draw stops

Finger protectors attached to a bowstring

Grip formers

Kisser buttons (all items attached to a bowstring to establish a consistent anchor point)

Nocking points (all items attached to a bowstring to establish arrow positioning)

Quivers designed to provide ready access to taxable arrows while an archer is engaged in target shooting, hunting, or fishing, regardless of material from which constructed (including bow quivers designed to be attached to a bow and ground quivers)

Release draw bars

String peeps (all items attached to a bowstring for use in sighting)

Arrow Parts and Accessories

(Prior to October 1, 1997)

Arrow fletching (natural feathers processed for application to arrows or synthetic feather substitutes)

Arrow nocks and inserts

Arrow points, tips, heads, adapters, and inserts

Arrow shafts

Arrow shaft material

Broadhead guide rings

Broadhead rings

Feather tracers

ARTICLES NOT SUBJECT TO TAX

Accessory belts

Archery armguards

Archery powder

Archery shooting finger tabs

Archery shooting gloves

Arrow clips for tackle boxes and display racks

Arrow cresting machines and replacement parts therefor

Arrow cut-off and fabricating tools (and replacement parts therefor)

Arrow fletching jigs and tools

Arrow lubes

Arrow pullers

Arrow shaft dip tanks

Arrow spine meters (and replacement parts therefor)

Arrow straighteners

Arrow tapering tools

Bow and arrow racks designed solely for the storage of bows and/or arrows

Bow and arrow cases designed for the transportation or storage of bows, arrows, and related equipment

Bowfishing line

Bow squares

Bow stringers

Bowstring jigs

Bowstring thread

Bowstring wax

Bow supports including ground bow holders and stands

Broadhead wrenches

Electronic trackers

Feather burners and feather burner kits (and replacement parts therefor)

Feathers not prepared for use with arrows

Feather waterproofing

Finger slings

Glues and cements

Nocking point tools

Powder pouches

Score card holder

Shirt and blouse protectors

String holders and keepers

String releases

String servers

Targets and target accessories

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 75-17 is supplemented and superseded.

DRAFTING INFORMATION

The principal author of this revenue ruling is Theodore N. Margopolos of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Mr. Margopolos on (202) 622-3130 (not a toll-free call).

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 1998. See Rev. Rul. 98-4, page 18.

Section 7872.—Treatment of Loans with Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 1998. See Rev. Rul. 98-4, page 18.

Part III. Administrative, Procedural, and Miscellaneous

Simplified Exclusion Ratio

Notice 98-2

I. Introduction

This notice replaces Notice 88-118, 1988-2 C.B. 450, to reflect certain changes to § 72 of the Internal Revenue Code of 1986 (the Code) made by the Small Business Job Protection Act of 1996, Pub. L. 104-188 (SBJPA) and by the Taxpayer Relief Act of 1997, Pub. L. 105-34 (TRA '97). Specifically, this notice describes the simplified method provided by § 72(d)(1) for determining the tax-free and taxable portions of certain annuity payments made from qualified plans under § 401(a), employee annuities under § 403(a), and annuity contracts under § 403(b).

In general, this new method applies to an annuity if the annuity starting date is after November 18, 1996. However, see Section V below for a transition rule for annuities with annuity starting dates after November 18, 1996 and before January 1, 1997. Unlike the safe-harbor method in Notice 88-118, the simplified method is required by the Code (rather than optional) and distributees must use this method in order to comply with § 72(d) of the Code as amended by SBJPA and TRA '97. Payors must also use this method to report the taxable portion of the annuity payments on Form 1099-R. The new method does not apply if the annuity starting date is on or before November 18, 1996.

II. Background

Section 402(a)(1) provides that the amount actually distributed to any distributee by an employees' trust described in § 401(a) which is exempt from tax under § 501(a) shall be taxable to the distributee, in the year in which distributed, under § 72 (relating to annuities). Similarly, amounts distributed from employee annuity contracts under § 403(a) and annuity contracts under § 403(b) are taxable to the distributee (in the year in which distributed) under § 72.

Section 72(b) provides that a portion of the annuity payments received in a taxable year may be excluded from gross in-

come as a return of the distributee's investment according to an exclusion ratio determined at the annuity starting date. The numerator of this ratio is the employee's investment in the contract, and the denominator is the expected return.

Section 72(e) provides rules relating to the taxability of amounts not received as annuities. Section 1.72-11(f) of the Income Tax Regulations provides rules for the treatment of a single-sum withdrawal received on or after the annuity starting date.

Notice 88-118 provided a simplified safe harbor method for determining the tax-free portion and taxable portion of certain annuity payments made from qualified plans under § 401(a), employee annuities under § 403(a), and annuity contracts under § 403(b). Under the safe harbor method of Notice 88-118, the exclusion ratio was determined by dividing the distributee's investment in the contract by an expected number of payments based upon the distributee's age. The result represented the tax-free portion of each payment. This safe harbor method could be elected only if the distributee received monthly payments and did not apply to installment payments that were not life contingent.

Section 1403 of SBJPA amended § 72(d) of the Code to require the use of a simplified method of recovering the investment in the contract for most annuity distributions from qualified plans under § 401(a), employee annuities under § 403(a), and § 403(b) annuity contracts. The simplified method of § 72(d) is similar to, but not the same as, the safe-harbor method that was provided in Notice 88-118. Section 1403 of SBJPA also provided a special rule where a single sum is received in connection with the commencement of annuity payments. In such a case, the single-sum payment is treated as if received before the annuity starting date. Generally, the SBJPA changes to § 72(d) of the Code apply to distributions with annuity starting dates after November 18, 1996.

Section 1075 of TRA '97 amended the simplified method of recovering the investment in the contract in § 72(d)(1)(B) of the Code to prescribe a different table

if the annuity is payable based on the lives of more than one individual. This new table applies to distributions with annuity starting dates after December 31, 1997. For annuities payable based on the life of only one individual, § 1075 of TRA '97 made no changes in the applicable table under the simplified method described by SBJPA.

III. Simplified Method

A. General

The simplified method provided in § 72(d) of the Code and this notice must be used by distributees to comply with § 72, and by payors to report the taxable portion of annuity distributions on Form 1099-R. If payments are made on a non-monthly basis, the simplified method applies with appropriate adjustments. However, this method does not apply if the annuitant is over age 75 and there are five or more years of guaranteed payments under the annuity.

B. Excluded Amount

Under the simplified method, the distributee recovers his or her investment in the contract in level amounts over the expected number of monthly payments determined from the tables below. The portion of each annuity payment that is excluded from gross income by a distributee for income tax purposes is a level dollar amount determined by dividing the investment in the contract by the set number of annuity payments from the tables below.

$$\frac{\text{Investment}}{\text{Expected Number of Monthly Payments}} = \text{Tax free portion of monthly annuity}$$

C. Expected Number of Monthly Payments

(1) Annuity Starting Dates After November 18, 1996 and Before January 1, 1998

Under the simplified method, for annuity starting dates beginning after November 18, 1996 but before January 1, 1998, the total number of monthly annuity payments expected to be received is based on the primary annuitant's age at the annuity

starting date. The same expected number of payments applies to an annuitant whether he or she is receiving a single life annuity or a joint and survivor annuity. The expected number of payments is set forth in the table below.

<u>Age of Primary Annuitant</u>	<u>Expected Number of Payments</u>
55 and under	360
56-60	310
61-65	260
66-70	210
71 and over	160

(2) Annuity Starting Dates After December 31, 1997

For annuity starting dates beginning after December 31, 1997, the table used to determine the expected number of payments depends on whether the payments are based on the life of more than one individual. In the case of an annuity payable based on the life of only one individual, the total number of monthly annuity payments expected to be received is based on the annuitant's age at the annuity starting date. An annuity which is payable over the life of one annuitant with a term certain feature is an annuity based on the life of that individual. Similarly, an annuity which is payable over the life of one annuitant with a temporary annuity payable to the annuitant's child until the child reaches an age specified in the plan (not more than age 25) is an annuity based on the life of that individual. The expected number of payments for an annuity based on the life of one individual is set forth in the table below.

<u>Age of Annuitant</u>	<u>Expected Number of Payments</u>
55 and under	360
56-60	310
61-65	260
66-70	210
71 and over	160

In the case of an annuity payable based on the life of more than one individual, the total number of monthly annuity payments expected to be received is based on the combined ages of the annuitants at the annuity starting date. If the annuity is payable to a primary annuitant and more than one survivor annuitant, the combined ages of the annuitants is the sum of the

age of the primary annuitant and the youngest survivor annuitant. If the annuity is payable to more than one survivor annuitant but there is no primary annuitant, the combined ages of the annuitants is the sum of the age of the oldest survivor annuitant and the youngest survivor annuitant. In addition, any survivor annuitant whose entitlement to payments is contingent on an event other than the death of the primary annuitant is disregarded. The expected number of payments is set forth in the table below.

<u>Combined Ages of Annuitants</u>	<u>Expected Number of Payments</u>
110 and under	410
111-120	360
121-130	310
131-140	260
141 and over	210

(3) Term Certain Annuities Without Life Contingencies

In the case of an annuity that does not depend in whole or in part on the life expectancy of one or more individuals, the expected number of payments is the number of monthly annuity payments under the contract.

D. Investment in the Contract

The investment in the contract is defined under § 72(c)(1) as the aggregate premiums or other consideration paid (generally, the aggregate amount of after-tax contributions made to the plan), reduced by amounts received before the annuity starting date that were excluded from gross income. In addition, § 72(c)(2) provides that the investment in the contract must be adjusted to reflect the value of any refund feature. Under § 72(d)(1)(C), as amended by SBJPA, for purposes of the simplified method, the investment in the contract is determined without regard to the adjustment for any refund feature as described in § 72(c)(2).

In certain cases, the investment in the contract could be increased by any death benefit exclusion that is allowed under § 101(b) if the employee death benefits are paid to a survivor in the form of an annuity, other than as a joint and survivor annuity. Section 101(b) was repealed by § 1402 of SBJPA effective with respect to decedents dying after August 20, 1996.

Accordingly, in the case of decedents dying after August 20, 1996, surviving beneficiaries no longer are permitted to increase the investment in the contract by the death benefit exclusion.

E. Application of Excluded Amount

The dollar amount determined above, as of the annuity starting date, will be excluded from each monthly annuity payment, even where the amount of the annuity payments change. For example, the amount to be excluded from each annuity payment determined at the annuity starting date remains constant, even if the amount of the annuity payments increases due to cost of living increases, or decreases in the case of a reduced survivor annuity after death of one of the annuitants.

If the amount to be excluded from each payment is greater than the amount of the annuity payment (e.g., because of decreased survivor payments), then each annuity payment will be completely excluded from gross income until the entire investment is recovered. For those distributees with annuity starting dates after December 31, 1986, annuity payments received after the investment is recovered (generally, after the expected number of payments has been received) are fully includible in gross income. If annuity payments cease by reason of death, a deduction for the unrecovered investment in the contract, if any, is allowed on the distributee's last income tax return.

Where two or more annuitants are receiving payments at the same time, each annuitant will exclude from each annuity payment a pro-rata portion of this amount determined according to a ratio, the numerator of which is the amount of the beneficiary's annuity payment, and the denominator of which is the total amount of the monthly annuity payments to all beneficiaries.

F. Adjustments for Non-Monthly Payments

In the case where annuity payments are not made on a monthly basis, under § 72(d)(1)(F) of the Code, an adjustment must be made to take into account the period on the basis of which such payments are made. One way to make this adjustment is to determine the number of ex-

pected payments by dividing the applicable expected number of months in the applicable table above by the number of months in each period. Another way (the result of which is equivalent to the first way) is to determine the tax-free portion of a monthly payment using the applicable expected number of months from the applicable table above and then multiply the resulting dollar amount per month by the number of months in each period.

G. Examples

The application of the simplified method is illustrated by the following examples. In all examples, the investment in the contract is stated as the employee's after-tax contributions and with no adjustment for the refund feature.

(i) Example 1

Upon retirement, Employee *A*, age 65, begins receiving retirement benefits in the form of a joint and 50 percent survivor annuity to be paid for the joint lives of *A* and *A*'s spouse, age 64. *A*'s annuity starting date is January 1, 1997. *A* made \$26,000

come. If *A* and *A*'s spouse die before 260 monthly payments have been made, a deduction is allowed for the last income tax return in the amount of the unrecovered investment.

(ii) Example 2

Upon retirement, Employee *B*, age 65, begins receiving retirement benefits in the form of a joint and 50 percent survivor annuity to be paid for the joint lives of *B* and *B*'s spouse, age 64. *B*'s annuity starting date is January 1, 1998. *B* contributed \$26,000 to the plan, and has received no distributions prior to the annuity starting date. *B* will receive a monthly retirement benefit of \$1,000 per month, and *B*'s spouse will receive a monthly survivor benefit of \$500 upon *B*'s death.

B's investment in the contract is \$26,000. The expected number of monthly payments is 310 for two distributees whose combined ages are 129. The tax-free portion of each \$1,000 monthly annuity payment to *B* is \$83.87, determined by dividing *B*'s investment

date. *C* will receive a quarterly retirement benefit of \$6,000, and *C*'s spouse will receive a quarterly survivor benefit of \$3,000 upon *C*'s death.

C's investment in the contract is \$42,000. Because the annuity starting date is prior to January 1, 1998, the expected number of monthly payments for a distributee who is age 66 is 210. Because *C*'s annuity is paid quarterly, the appropriate adjustment is to divide the expected number of payments (210) by the number of months in the period (3), which equals 70. Thus, the tax-free portion of each \$6,000 quarterly annuity payment to *C* is \$600, determined by dividing *C*'s investment (\$42,000) by the expected number of quarterly payments (70).

$$\frac{\$42,000 \text{ investment}}{70 \text{ quarterly payments}} = \$600 \text{ return of investment per quarter}$$

Alternatively, the appropriate adjustment can be made by dividing \$42,000 by 210 and multiplying the resulting \$200 per month by the number of months in the period, three (3), which equals a \$600 return of investment per quarter.

$$\frac{\$42,000 \text{ investment}}{210 \text{ monthly payments}} \times 3 \text{ months per quarter} = \$600 \text{ return of investment per quarter}$$

of after-tax contributions to the plan and has received no distributions prior to the annuity starting date. *A* will receive a monthly retirement benefit of \$1,000, and *A*'s spouse will receive a monthly survivor benefit of \$500 upon *A*'s death.

A's investment in the contract is \$26,000. Because the annuity starting date is prior to January 1, 1998, the expected number of monthly payments for a distributee who is age 65 is 260. The tax-free portion of each \$1,000 monthly annuity payment to *A* is \$100, determined by dividing *A*'s investment (\$26,000) by the expected number of payments (260).

$$\frac{\$26,000 \text{ investment}}{260 \text{ monthly payments}} = \$100 \text{ return of investment per month}$$

Upon *A*'s death, if *A* has not recovered the full \$26,000 investment, *A*'s spouse will also exclude \$100 from each \$500 monthly annuity payment.

Any annuity payments received after the 260 monthly payments have been made will be fully includible in gross in-

(\$26,000) by the expected number of payments (310).

$$\frac{\$26,000 \text{ investment}}{310 \text{ monthly payments}} = \$83.87 \text{ return of investment per month}$$

Upon *B*'s death, if *B* has not recovered the full \$26,000 investment, *B*'s spouse will also exclude \$83.87 from each \$500 monthly annuity payment.

Any annuity payments received after the 310 monthly payments have been made will be fully includible in gross income. If *B* and *B*'s spouse die before 310 monthly payments have been made, a deduction is allowed for the last income tax return in the amount of the unrecovered investment.

(iii) Example 3.

Upon retirement, Employee *C*, age 66, begins receiving retirement benefits in the form of a joint and 50 percent survivor annuity to be paid for the joint lives of *C* and *C*'s spouse, age 65. *C*'s annuity starting date is January 1, 1997. *C* contributed \$42,000 to the plan, and has received no distributions prior to the annuity starting

(iv) Example 4.

Upon retirement, Employee *D*, age 57, begins receiving retirement benefits in the form of a joint and 50 percent survivor annuity to be paid for the joint lives of *D* and *D*'s spouse, age 57. *D* contributed \$31,000 to the plan. *D*'s annuity starting date is July 1, 1998. On *D*'s annuity starting date, in connection with receiving the first annuity payment, *D* receives a single-sum payment of \$10,000. Had the single-sum payment of \$10,000 been received prior to *D*'s annuity starting date, then under the rules of § 72(e), \$2,000 would have been considered as a recovery of *D*'s investment in the contract. *D* will receive a monthly retirement benefit of \$1,500 per month, and *D*'s spouse will receive a monthly survivor benefit of \$750 upon *D*'s death.

Because the \$10,000 is treated as if received before the annuity starting date, *D* will include \$8,000 in income as a result of the single-sum payment (\$10,000 minus \$2,000) and for purposes of determining the tax-free portion of each annu-

ity payment, *D*'s investment in the contract is \$29,000 (the after-tax contributions to the plan minus the \$2,000 portion of the single-sum payment representing the recovery of *D*'s investment in the contract). The expected number of monthly payments for two annuitants whose combined ages are 114 is 360. The tax-free portion of each \$1,500 monthly annuity payment to *D* is \$80.56, determined by dividing *D*'s investment (\$29,000) by the expected number of payments (360).

$$\frac{\$29,000 \text{ investment}}{360 \text{ monthly payments}} = \$80.56 \text{ return of investment per month}$$

Upon *D*'s death, if *D* has not recovered the full \$29,000 investment, *D*'s spouse will also exclude \$80.56 from each \$750 monthly annuity payment.

Any annuity payments received after the 360 monthly payments have been made will be fully includible in gross income. If *D* and *D*'s spouse die before 360 monthly payments have been made, a deduction is allowed for the last income tax

88-118) may be used to determine the taxable and tax-free portions of annuity payments received in 1996 and 1997. Accordingly, under this transition rule, payors are not to re-issue Forms 1099-R for 1996 (and 1997, if applicable), and distributees are not to file amended income tax returns for 1996 (and 1997, if applicable), solely because they failed to take into account the changes to § 72(d) of the Code made by SBJPA.

However, under this transition rule, a payor who reports the taxable portion of annuity payments on Form 1099-R must determine the taxable and tax-free portion of annuity payments using the transition method described below. The transition method must be applied to annuity payments made on and after January 1, 1998. However, payors may choose to apply the transition method for annuity payments made on an earlier date (for example, payments made on and after January 1, 1997). Under the transition method, the tax-free portion of each annuity payment made on

A was determined under Notice 88-118. This tax-free portion was \$108.33, calculated as follows.

$$\frac{\$26,000 \text{ investment}}{240 \text{ monthly payments}} = \$108.33 \text{ return of investment}$$

The \$108.33 was treated as tax-free for the 1996 return. Under the transition rule, this treatment for 1996 is allowed. However, the taxable and tax-free portions must be redetermined using the transition method with a transition date of January 1, 1998, or earlier.

Assume that A uses January 1, 1997 as the transition date. For annuity payments received after December 31, 1996, determine the tax-free portion of each \$1,000 annuity payment by dividing the remaining investment in the contract by the remaining number of expected payments as of the transition date, determined in accordance with § 72(d) and this notice. Accordingly, the tax-free portion of each \$1,000 payment received in 1997 and later years is \$99.97, determined as follows.

$$\frac{25,891.67 (\$26,000 \text{ minus } \$108.33)}{259 \text{ payments } (260 \text{ minus } 1)} = \$99.97 \text{ return of investment}$$

return in the amount of the unrecovered investment.

IV. Effective Date

The simplified method described in this notice is generally effective for annuities with annuity starting dates after November 18, 1996. For annuity starting dates after December 31, 1997, if the annuity is payable based on the lives of more than one individual, the simplified method based on the combined ages of the annuitants is to be used.

V. Transition Rule

Some payors and distributees may have continued to use the law in effect prior to SBJPA (including the safe-harbor method contained in Notice 88-118) for annuity starting dates after November 18, 1996 and before January 1, 1997. This notice contains a transition rule for these payors and distributees.

Under this transition rule, for annuities with annuity starting dates after November 18, 1996 and before January 1, 1997, the law in effect prior to SBJPA (including the methodology contained in Notice

and after the transition date is determined by dividing the remaining investment in the contract by the remaining number of expected payments. The remaining investment in the contract is the distributee's original investment in the contract as of the annuity starting date, minus the amount of the investment in the contract treated as recovered after the annuity starting date and prior to the transition date. The remaining number of expected monthly payments is the total number of expected monthly payments as of the annuity starting date (as determined by the table in section III(C)(1) of this notice) minus the number of payments made prior to the transition date. Where the payor does not report the taxable portion of annuity payments on Form 1099-R, a distributee who uses the transition rule must determine the taxable and tax-free portions of annuity payments using the transition method described in this paragraph.

(i) Example of Transition Rule

Assume the same facts as in Example 1 except that A's annuity starting date is December 1, 1996. The tax-free portion of each \$1,000 monthly annuity payment to

Under this method, the total amount of annuity payments that is tax-free is \$26,000.

VI. Effect on Other Documents

Notice 88-118 is obsolete.

Drafting 1'

The principal author of this notice is Todd Newman of the Employee Plans Division. For further information please contact the Employee Plans Division's taxpayer assistance telephone service between the hours of 2:30 p.m. and 3:30 p.m. Eastern time, Monday through Thursday on (202) 622-6076 (not a toll-free call). Mr. Newman's telephone number is (202) 622-6262 (also not a toll-free call).

SIMPLE IRA Plan Guidance

Notice 98-4

PURPOSE

This notice modifies and supersedes Notice 97-6, 1997-2 I.R.B. 26, relating to SIMPLE IRA Plans described in § 408(p)

of the Internal Revenue Code. The questions and answers contained in this notice reflect technical corrections made by the Taxpayer Relief Act of 1997, Pub. L. 105-34 ("TRA 97"). This notice also amends the answers to certain questions in Notice 97-6 in order to reflect the issuance of Form 5304-SIMPLE (Not Subject to the Designated Financial Institution Rules) and provides a transition period for the use of Form 5305-SIMPLE (for Use With a Designated Financial Institution) for a SIMPLE IRA Plan that does not use a designated financial institution.

BACKGROUND

Section 1421 of the Small Business Job Protection Act of 1996, Pub. L. 104-188 ("SBJPA") established a simplified tax-favored retirement plan for small employers (a "SIMPLE IRA Plan") under § 408(p) of the Code. Contributions under a SIMPLE IRA Plan are made to individual retirement accounts or annuities ("SIMPLE IRAs") that are established pursuant to the SIMPLE IRA Plan adopted by the employer.

Section 1601(d)(1) of TRA 97 amended § 1421 of SBJPA, making technical changes to the statutory requirements for SIMPLE IRA Plans.

Notice 97-6 was issued on December 23, 1996, and provided guidance, in the form of questions and answers, on SIMPLE IRA Plans.

On October 31, 1996, the Internal Revenue Service issued Form 5305-SIMPLE, a model form that may be used by an employer to establish a SIMPLE IRA Plan with a designated financial institution, and on December 30, 1996, the Service issued 5304-SIMPLE, a model form that may be used by an employer to establish a SIMPLE IRA Plan without using a designated financial institution. Notice 97-6 contained instructions for modifying Form 5305-SIMPLE for an employer that did not want to use a designated financial institution but that wanted to use a Service-approved model form to establish a SIMPLE IRA Plan. Form 5304-SIMPLE is now available for this purpose.

On November 25, 1997, the Department of Labor ("DOL") issued a final rule, consistent with the statements in Q&A G-5 of Notice 97-6, amending 29 CFR 2510.3-102, relating to the defini-

tion of "plan assets" under Title I of the Employee Retirement Income Security Act of 1974 ("ERISA"), to harmonize those Title I rules with the rules for salary reduction contributions to SIMPLE IRA Plans under § 408(p) of the Code.

CHANGES TO NOTICE 97-6

This notice modifies Q&As B-3, C-1 and H-2 to reflect technical corrections made by TRA 97; Q&A G-5 to reflect the amendment to the DOL plan asset regulations; and Q&As E-4, G-1, H-1 and K-3 to reflect the issuance of Form 5304-SIMPLE. A new Q&A, K-4, is added to provide a transition period for employers using Form 5305-SIMPLE as modified in accordance with Notice 97-6 for a SIMPLE IRA Plan that does not use a designated financial institution. In addition, this notice makes certain stylistic changes to the Q&As as published in Notice 97-6, including substituting the term "SIMPLE IRA Plan" for "SIMPLE plan."

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QUESTIONS AND ANSWERS

A. SIMPLE IRA PLANS IN GENERAL

Q. A-1: What is a SIMPLE IRA Plan?

A. A-1: A SIMPLE IRA Plan is a written arrangement established under § 408(p) of the Code that provides a simplified tax-favored retirement plan for small employers. If an employer establishes a SIMPLE IRA Plan, each employee may choose whether to have the employer make payments as contributions

under the SIMPLE IRA Plan or to receive these payments directly in cash. An employer that chooses to establish a SIMPLE IRA Plan must make either matching contributions or nonelective contributions. All contributions under a SIMPLE IRA Plan are made to SIMPLE IRAs.

Q. A-2: Can contributions made under a SIMPLE IRA Plan be made to any type of IRA?

A. A-2: Contributions under a SIMPLE IRA Plan may only be made to a SIMPLE IRA, not to any other type of IRA. A SIMPLE IRA is an individual retirement account described in § 408(a), or an individual retirement annuity described in § 408(b), to which the only contributions that can be made are contributions under a SIMPLE IRA Plan and rollovers or transfers from another SIMPLE IRA.

Q. A-3: Can a SIMPLE IRA Plan be maintained on a fiscal year basis?

A. A-3: A SIMPLE IRA Plan may only be maintained on a calendar year basis. Thus, for example, employer eligibility to establish a SIMPLE IRA Plan (see Q&As B-1 through B-5) and SIMPLE IRA Plan contributions (see Q&As D-1 through D-6) are determined on a calendar-year basis.

B. EMPLOYERS THAT CAN ESTABLISH SIMPLE IRA PLANS

Q. B-1: Can any employer establish a SIMPLE IRA Plan?

A. B-1: SIMPLE IRA Plans may be established only by employers that had no more than 100 employees who earned \$5,000 or more in compensation during the preceding calendar year (the "100-employee limitation"). See Q&As C-4 and C-5 for the definition of compensation. For purposes of the 100-employee limitation, all employees employed at any time during the calendar year are taken into account, regardless of whether they are eligible to participate in the SIMPLE IRA Plan. Thus, employees who are excludable under the rules of § 410(b)(3) or who have not met the plan's minimum eligibility requirements must be taken into account. Employees also include self-employed individuals described in § 401(c)(1) who received earned income from the employer during the year.

Q. B-2: Is there a grace period that can be used by an employer that ceases to satisfy the 100-employee limitation?

A. B-2: An employer that previously maintained a SIMPLE IRA Plan is treated as satisfying the 100-employee limitation for the 2 calendar years immediately following the calendar year for which it last satisfied the 100-employee limitation. However, if the failure to satisfy the 100-employee limitation is due to an acquisition, disposition or similar transaction involving the employer, then the 2-year grace period will apply only in accordance with rules similar to the rules of § 410(b)(6)(C)(i).

Q. B-3: Can an employer make contributions under a SIMPLE IRA Plan for a calendar year if it maintains another qualified plan?

A. B-3: Generally, an employer cannot make contributions under a SIMPLE IRA Plan for a calendar year if the employer, or a predecessor employer, maintains a qualified plan (other than the SIMPLE IRA Plan) under which any of its employees receives an allocation of contributions (in the case of a defined contribution plan) or has an increase in a benefit accrued or treated as an accrued benefit under § 411(d)(6) (in the case of a defined benefit plan) for any plan year beginning or ending in that calendar year. In applying these rules, transfers, rollovers or forfeitures are disregarded, except to the extent forfeitures replace otherwise required contributions. For purposes of this Q&A B-3, “qualified plan” means a plan, contract, pension or trust described in § 219(g)(5) and includes a plan qualified under § 401(a), a qualified annuity plan described in § 403(a), an annuity contract described in § 403(b), a plan established for employees of a State, a political subdivision or by an agency or instrumentality of any State or political subdivision (other than an eligible deferred compensation plan described in § 457(b)), a simplified employee pension (“SEP”) described in § 408(k), a trust described in § 501(c)(18) and a SIMPLE IRA Plan described in § 408(p).

However, an employer can make contributions under a SIMPLE IRA Plan for a calendar year even though it maintains another qualified plan if either:

(1) The other qualified plan maintained by the employer covers only employees described in paragraph (1) of Q&A C-1 (i.e., employees covered under a collective bargaining agreement for which retirement benefits were the subject of good

faith bargaining) and the SIMPLE IRA Plan excludes these employees.

(2) The other qualified plan is maintained by the employer during the calendar year in which an acquisition, disposition or similar transaction occurs (or the following calendar year); the requirements of this Q&A B-3 would have been satisfied if the transaction had not occurred (and thus the employer maintaining the SIMPLE IRA Plan had remained a separate employer); and only individuals who would have been employees of that “separate” employer are eligible to participate in the SIMPLE IRA Plan.

Q. B-4: Are tax-exempt employers and governmental entities permitted to maintain SIMPLE IRA Plans?

A. B-4: Yes. Excludable contributions may be made to the SIMPLE IRA of employees of tax-exempt employers and governmental entities on the same basis as contributions may be made to employees of other eligible employers.

Q. B-5: Do the employer aggregation and leased employee rules apply for purposes of the SIMPLE IRA Plan rules under § 408(p)?

A. B-5: For purposes of applying the SIMPLE IRA Plan rules under § 408(p), certain related employers (trades or businesses under common control) are treated as a single employer. These related employers include controlled groups of corporations under § 414(b), partnerships or sole proprietorships under common control under § 414(c), and affiliated service groups under § 414(m). In addition, leased employees described in § 414(n) are treated as employed by the employer.

Example: Individual P owns Business A, a computer rental agency, that has 80 employees who received more than \$5,000 in compensation in 1996. Individual P also owns Business B, which repairs computers and has 60 employees who received more than \$5,000 in compensation in 1996. Individual P is the sole proprietor of both businesses. Section 414(c) provides that the employees of partnerships and sole proprietorships that are under common control are treated as employees of a single employer. Thus, for purposes of the SIMPLE IRA Plan rules, all 140 employees are treated as employed by Individual P. Therefore, neither Business A nor Business B is eligible to establish a SIMPLE IRA Plan for 1997.

C. EMPLOYEE ELIGIBILITY TO PARTICIPATE IN A SIMPLE IRA PLAN

Q. C-1: Which employees of an employer must be eligible to participate under the SIMPLE IRA Plan?

A. C-1: If an employer establishes a SIMPLE IRA Plan, all employees of the employer who received at least \$5,000 in compensation from the employer during any 2 preceding calendar years (whether or not consecutive) and who are reasonably expected to receive at least \$5,000 in compensation during the calendar year, must be eligible to participate in the SIMPLE IRA Plan for the calendar year.

An employer, at its option, may exclude from eligibility employees described in § 410(b)(3). These employees are:

(1) Employees who are included in a unit of employees covered by an agreement that the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and one or more employers, if there is evidence that retirement benefits were the subject of good faith bargaining between such employee representatives and such employer or employers;

(2) In the case of a trust established or maintained pursuant to an agreement that the Secretary of Labor finds to be a collective bargaining agreement between air pilots represented in accordance with Title II of the Railway Labor Act and one or more employees, all employees not covered by that agreement; and

(3) Employees who are nonresident aliens and who received no earned income (within the meaning of § 911(d)(2)) from the employer that constitutes income from sources within the United States (within the meaning of § 861(a)(3)).

Moreover, during the calendar year in which an acquisition, disposition or similar transaction occurs (or the following calendar year), an employer may exclude from eligibility all of the employees who would not have been eligible if the transaction had not occurred (and thus the employer maintaining the SIMPLE IRA Plan had remained a separate employer). See paragraph (2) of Q&A B-3 for circumstances in which exclusion of these employees would be required.

As noted in Q&A B-5, the employer aggregation and leased employee rules

apply for purposes of § 408(p). Thus, for example, if two related employers must be aggregated under the rules of § 414(b), all employees of either employer who satisfy the eligibility criteria must be allowed to participate in the SIMPLE IRA Plan.

Q. C-2: May an employer impose less restrictive eligibility requirements?

A. C-2: An employer may impose less restrictive eligibility requirements by eliminating or reducing the prior year compensation requirements, the current year compensation requirements, or both, under its SIMPLE IRA Plan. For example, the employer could allow participation for employees who received \$3,000 in compensation during any preceding calendar year. However, the employer cannot impose any other conditions on participating in a SIMPLE IRA Plan.

Q. C-3: May an employee participate in a SIMPLE IRA Plan if he or she also participates in a plan of a different employer for the same year?

A. C-3: An employee may participate in a SIMPLE IRA Plan even if he or she also participates in a plan of a different employer for the same year. However, the employee's salary reduction contributions are subject to the limitations of § 402(g), which provides an aggregate limit on the exclusion for elective deferrals for any individual. Similarly, an employee who participates in a SIMPLE IRA Plan and an eligible deferred compensation plan described in § 457(b) is subject to the limitations described in § 457(c). An employer that establishes a SIMPLE IRA Plan is not responsible for monitoring compliance with either of these limitations.

Q. C-4: What definition of compensation applies for purposes of the SIMPLE IRA Plan rules in the case of an individual who is not a self-employed individual?

A. C-4: For purposes of the SIMPLE IRA Plan rules, in the case of an individual who is not a self-employed individual, compensation means the amount described in § 6051(a)(3) (wages, tips, and other compensation from the employer subject to income tax withholding under § 3401(a)), and amounts described in § 6051(a)(8), including elective contributions made under a SIMPLE IRA Plan, and compensation deferred under a § 457 plan. For purposes of applying the 100-

employee limitation, and in determining whether an employee is eligible to participate in a SIMPLE IRA Plan (i.e., whether the employee had \$5,000 in compensation for any 2 preceding years), an employee's compensation also includes the employee's elective deferrals under a § 401(k) plan, a salary reduction SEP and a § 403(b) annuity contract.

Q. C-5: What definition of compensation applies for purposes of the SIMPLE IRA Plan rules in the case of a self-employed individual?

A. C-5: For purposes of the SIMPLE IRA Plan rules, in the case of a self-employed individual, compensation means net earnings from self-employment determined under § 1402(a), prior to subtracting any contributions made under the SIMPLE IRA Plan on behalf of the individual.

D. SIMPLE IRA PLAN CONTRIBUTIONS

Q. D-1: What contributions must an employer make under a SIMPLE IRA Plan?

A. D-1: If an employer establishes a SIMPLE IRA Plan, it must make salary reduction contributions, as described in Q&A D-2, to the extent elected by employees. In addition, the employer must make employer matching contributions, as described in Q&As D-4 and D-5, or employer nonelective contributions, as described in Q&A D-6. These are the only contributions that may be made under a SIMPLE IRA Plan.

Q. D-2: What is a salary reduction contribution?

A. D-2: A salary reduction contribution is a contribution made pursuant to an employee's election to have an amount contributed to his or her SIMPLE IRA, rather than have the amount paid directly to the employee in cash. An employee must be permitted to elect to have salary reduction contributions made at the level specified by the employee, expressed as a percentage of compensation for the year. Additionally, an employer may permit an employee to express the level of salary reduction contributions as a specific dollar amount. An employer may not place any restrictions on the amount of an employee's salary reduction contributions (e.g., by limiting the contribution percentage), except to the extent needed to com-

ply with the annual limit on the amount of salary reduction contributions described in Q&A D-3.

Q. D-3: What is the annual limit on the amount of salary reduction contributions under a SIMPLE IRA Plan?

A. D-3: For 1997 (and for 1998), the maximum annual amount of salary reduction contributions that can be made on behalf of any employee under a SIMPLE IRA Plan is \$6,000. This amount will be adjusted by the Service to reflect any changes in the cost of living.

Q. D-4: What employer matching contribution is generally required under a SIMPLE IRA Plan?

A. D-4: Under a SIMPLE IRA Plan, an employer is generally required to make a contribution on behalf of each eligible employee in an amount equal to the employee's salary reduction contributions, up to a limit of 3 percent of the employee's compensation for the entire calendar year.

Q. D-5: Can the 3-percent limit on matching contributions be reduced?

A. D-5: The 3-percent limit on matching contributions is permitted to be reduced for a calendar year at the election of the employer, but only if:

- (1) The limit is not reduced below 1 percent;
- (2) The limit is not reduced for more than 2 years out of the 5-year period that ends with (and includes) the year for which the election is effective; and
- (3) Employees are notified of the reduced limit within a reasonable period of time before the 60-day election period during which employees can enter into salary reduction agreements. See Q&A E-1.

For purposes of applying the rule described in paragraph (2) of this Q&A D-5, in determining whether the limit was reduced below 3 percent for a year, any year before the first year in which an employer (or a predecessor employer) maintains a SIMPLE IRA Plan will be treated as a year for which the limit was 3 percent. If an employer chooses to make nonelective contributions for a year (see Q&A D-6), that year also will be treated as a year for which the limit was 3 percent.

Q. D-6: May an employer make nonelective contributions instead of matching contributions?

A. D-6: As an alternative to making matching contributions under a SIMPLE IRA Plan (as described in Q&A D-4 and D-5), an employer may make nonelective contributions equal to 2 percent of each eligible employee's compensation for the entire calendar year. The employer's nonelective contributions must be made for each eligible employee regardless of whether the employee elects to make salary reduction contributions for the calendar year. The employer may, but is not required to, limit nonelective contributions to eligible employees who have at least \$5,000 (or some lower amount selected by the employer) of compensation for the year.

For purposes of the 2-percent nonelective contribution, the compensation taken into account must be limited to the amount of compensation that may be taken into account under § 401(a)(17) for the year. The § 401(a)(17) limit for 1997 (and for 1998) is \$160,000. This amount will be adjusted by the Service for subsequent years to reflect changes in the cost of living.

An employer may substitute the 2-percent nonelective contribution for the matching contribution for a year, only if:

(1) Eligible employees are notified that a 2-percent nonelective contribution will be made instead of a matching contribution; and

(2) This notice is provided within a reasonable period of time before the 60-day election period during which employees can enter into salary reduction agreements. See Q&A E-1.

E. EMPLOYEE ELECTIONS

Q. E-1: When must an employee be given the right to enter into a salary reduction agreement?

A. E-1: During the 60-day period immediately preceding January 1 of a calendar year (i.e., November 2 to December 31 of the preceding calendar year), an eligible employee must be given the right to enter into a salary reduction agreement for the calendar year, or to modify a prior agreement (including reducing the amount subject to this agreement to \$0). However, for the year in which the employee becomes eligible to make salary reduction contributions, the period during which the employee may enter into a salary reduction agreement or modify a

prior agreement is a 60-day period that includes either the date the employee becomes eligible or the day before that date. For example, if an employer establishes a SIMPLE IRA Plan effective as of July 1, 1997, each eligible employee becomes eligible to make salary reduction contributions on that date and the 60-day period must begin no later than July 1 and cannot end before June 30, 1997.

During these 60-day periods, employees have the right to modify their salary reduction agreements without restrictions. In addition, for the year in which an employee becomes eligible to make salary reduction contributions, the employee must be able to commence these contributions as soon as the employee becomes eligible, regardless of whether the 60-day period has ended.

Q. E-2: Can a SIMPLE IRA Plan provide additional or longer election periods?

A. E-2: Nothing precludes a SIMPLE IRA Plan from providing additional or longer periods for permitting employees to enter into salary reduction agreements or to modify prior agreements. For example, a SIMPLE IRA Plan can provide a 90-day election period instead of the 60-day period described in Q&A E-1. Similarly, in addition to the 60-day period described in Q&A E-1, a SIMPLE IRA Plan can provide quarterly election periods during the 30 days before each calendar quarter.

Q. E-3: Does an employee have the right to terminate a salary reduction agreement outside a SIMPLE IRA Plan's normal election period?

A. E-3: An employee must be given the right to terminate a salary reduction agreement for a calendar year at any time during the year. A SIMPLE IRA Plan may provide that an employee who terminates a salary reduction agreement at any time other than the periods described in Q&A E-1 or E-2 is not eligible to resume participation until the beginning of the next calendar year.

Q. E-4: Must an employer allow an employee to select the financial institution to which the employer will make all SIMPLE IRA Plan contributions on behalf of the employee?

A. E-4: Generally, under § 408(p), an employer must permit an employee to select the financial institution for the SIMPLE IRA to which the employer will

make all contributions on behalf of the employee. The employee must communicate to the employer the name of the financial institution selected and any additional information necessary to facilitate transmittal of the contribution to that institution. The Model Salary Reduction Agreement on page 3 of Form 5304-SIMPLE can be used for this purpose. Alternatively, under the exception described in Q&A J-1, an employer may require that all contributions on behalf of employees be made to a specified designated financial institution.

F. VESTING REQUIREMENTS

Q. F-1: Must contributions under a SIMPLE IRA Plan be nonforfeitable?

A. F-1: Yes. All contributions under a SIMPLE IRA Plan must be fully vested and nonforfeitable when made.

Q. F-2: May amounts held in a SIMPLE IRA be withdrawn at any time?

A. F-2: Yes. An employer may not require an employee to retain any portion of the contributions in his or her SIMPLE IRA or otherwise impose any withdrawal restrictions.

G. EMPLOYER ADMINISTRATIVE AND NOTIFICATION REQUIREMENTS

Q. G-1: What notification requirements apply to employers?

A. G-1: An employer must notify each employee, immediately before the employee's 60-day election period described in Q&A E-1, of the employee's opportunity to enter into a salary reduction agreement or to modify a prior agreement. If applicable, this notification must disclose an employee's ability to select the financial institution that will serve as the trustee of the employee's SIMPLE IRA as described in Q&A E-4. In the case of a SIMPLE IRA Plan established using Form 5304-SIMPLE (Not Subject to the Designated Financial Institution Rules), the employer may use the Model Notification to Eligible Employees on page 3 of the form to disclose to each employee the employee's right to select the financial institution that will serve as the trustee of the employee's SIMPLE IRA as described in Q&A E-4. The notification must also include the summary description described in Q&A H-1. In the case of a

SIMPLE IRA Plan established using Form 5304-SIMPLE (Not Subject to the Designated Financial Institution Rules) or Form 5305-SIMPLE (for Use With a Designated Financial Institution), the summary description requirement may be satisfied by providing a completed copy of pages 1 and 2 of the form that reflects the terms of the employer's plan (including the materials provided by the trustee for completion of Article VI).

Q. G-2: May the notifications regarding a reduced matching contribution (described in Q&A D-5) and a nonelective contribution in lieu of a matching contribution (described in Q&A D-6) be provided at the same time as the notification of an employee's opportunity to enter into a salary reduction agreement and the summary description?

A. G-2: Yes. An employer is deemed to provide the notification regarding a reduced matching contribution or a nonelective contribution in lieu of a matching contribution within a reasonable period of time before the 60-day election period if, immediately before the 60-day election period, this notification is included with the notification of an employee's opportunity to enter into a salary reduction agreement.

Q. G-3: What reporting penalties under the Code apply if an employer fails to provide one or more of the required notices?

A. G-3: If the employer fails to provide one or more of the required notices described in Q&A G-1, the employer will be liable, under the Code, for a penalty of \$50 per day until the notices are provided. If the employer shows that the failure was due to reasonable cause, the penalty will not be imposed. To the extent that each employee is permitted to select the trustee for his or her SIMPLE IRA pursuant to Q&A E-4, and is so notified in accordance with Q&A G-1, and the information with respect to the trustee (the name and address of the trustee and its withdrawal procedures) is not available at the time the employer is required to provide the summary description, the employer is deemed to have shown reasonable cause for failure to provide this information to eligible employees, but only if the employer sees to it that this information is provided to the employee as soon as administratively feasible once the trustee has been selected.

Q. G-4: What if an eligible employee is unwilling or unable to establish a SIMPLE IRA?

A. G-4: If an eligible employee who is entitled to a contribution under a SIMPLE IRA Plan is unwilling or unable to establish a SIMPLE IRA with any financial institution prior to the date on which the contribution is required to be made to the SIMPLE IRA of the employee under Q&A G-5 or G-6, an employer may execute the necessary documents to establish a SIMPLE IRA on the employee's behalf with a financial institution selected by the employer.

Q. G-5: When must an employer make salary reduction contributions under a SIMPLE IRA Plan?

A. G-5: The employer must make salary reduction contributions to the financial institution maintaining the SIMPLE IRA no later than the close of the 30-day period following the last day of the month in which amounts would otherwise have been payable to the employee in cash. The Department of Labor has indicated that most SIMPLE IRA Plans are also subject to Title I of ERISA, and under Department of Labor regulations, at 29 CFR 2510.3-102, salary reduction contributions to these plans must be made to the SIMPLE IRA as of the earliest date on which the contributions can reasonably be segregated from the employer's general assets, but in no event later than the 30-day deadline described above.

Q. G-6: When must an employer make matching and nonelective contributions under a SIMPLE IRA Plan?

A. G-6: Matching and nonelective employer contributions must be made to the financial institution maintaining the SIMPLE IRA no later than the due date for filing the employer's income tax return, including extensions, for the taxable year that includes the last day of the calendar year for which the contributions are made.

H. TRUSTEE ADMINISTRATIVE REQUIREMENTS

Q. H-1: What information must a SIMPLE IRA trustee provide to an employer?

A. H-1: (1) *Summary description.* Each year, a SIMPLE IRA trustee must provide the employer sponsoring the SIMPLE IRA Plan with a summary de-

scription containing the following information:

(a) The name and address of the employer and the trustee.

(b) The requirements for eligibility for participation.

(c) The benefits provided with respect to the arrangement.

(d) The time and method of making employee elections with respect to the arrangement.

(e) The procedures for, and effects of, withdrawals (including rollovers) from the arrangement.

(2) *Timing.* Each trustee must provide the summary description to the employer early enough to allow the employer to meet its notification obligation described in Q&A G-1. However, a trustee is not required to provide the summary description prior to agreeing to be a trustee of a SIMPLE IRA under the SIMPLE IRA Plan.

(3) *Penalties.* Each trustee that fails to provide the employer with one or more summary descriptions incurs a \$50 penalty, under § 6693(c) of the Code, for each day the failures continue, unless the trustee shows that the failures are due to reasonable cause. To the extent that the employer or a trustee provides the information described in paragraphs (1)(a) through (e) of this Q&A H-1 within the time period prescribed in Q&A G-1 to the employee for whom the SIMPLE IRA is established, the trustee of that SIMPLE IRA is deemed to have shown reasonable cause for failure to provide that information to the employer. For example, if, in accordance with Q&A G-1, an employer who uses a designated financial institution provides, to all eligible employees in a SIMPLE IRA Plan, its name and address, the information described in paragraphs (1)(a) through (d) of this Q&A H-1, and the effects of withdrawal, and the trustee provides its name and address and its procedures for withdrawal to each eligible employee for whom a SIMPLE IRA is established with the trustee under the SIMPLE IRA Plan, the trustee will be deemed to have shown reasonable cause for failing to provide the employer the information described in paragraphs (1)(a) through (e) of this Q&A H-1.

(4) *Use of model forms as the summary description.* In the case of a SIMPLE IRA Plan established using Form 5304-

SIMPLE (Not Subject to the Designated Financial Institution Rules) or Form 5305-SIMPLE (for Use With a Designated Financial Institution), a trustee may satisfy this obligation by providing an employer (and/or the employee in the case of Form 5304-SIMPLE) with a current copy of Form 5304-SIMPLE or Form 5305-SIMPLE, the instructions, the information required for completion of Article VI, and the name and address of the financial institution. The trustee should provide guidance to the employer (and the employee, if Form 5304-SIMPLE is provided directly to the employee) concerning the need for the employer to complete the first two pages of Form 5304-SIMPLE or Form 5305-SIMPLE in accordance with its plan's terms and to distribute completed copies to eligible employees.

(5) *Transfer SIMPLE IRAs.* The trustee of a transfer SIMPLE IRA is not required to provide the summary description described in the preceding paragraph. A SIMPLE IRA is a transfer SIMPLE IRA if it is not a SIMPLE IRA to which the employer has made contributions under the SIMPLE IRA Plan.

Q. H-2: What information must a SIMPLE IRA trustee provide to participants in the SIMPLE IRA Plan?

A. H-2: Within 31 days after the close of each calendar year, a SIMPLE IRA trustee must provide each individual on whose behalf an account is maintained with a statement of the individual's account balance as of the close of that calendar year and the account activity during that calendar year. A trustee who fails to provide individuals with this statement incurs a \$50 penalty, under the Code, for each day the failure continues, unless the trustee shows that the failure is due to reasonable cause. The trustee must also provide any other information required to be furnished to IRA holders (e.g., disclosure statements for individual retirement plans as referred to in § 1.408-6 of the regulations).

Q. H-3: What information must a SIMPLE IRA trustee provide to the Service?

A. H-3: Section 408(i) requires the trustee of an individual retirement account to make reports regarding these accounts to the Service. Form 5498, Individual Retirement Arrangement Information, has been

modified to require that the amount of contributions to a SIMPLE IRA, rollover contributions, and the fair market value of the account be reported, and that contributions to a SIMPLE IRA be identified as such. A trustee who fails to file these reports incurs a \$50 penalty under the Code for each failure, unless it is shown that the failure is due to reasonable cause.

Q. H-4: Are distributions from a SIMPLE IRA required to be reported on Form 1099-R?

A. H-4: Pursuant to § 6047 of the Code and § 35.3405-1 of the regulations, the payor of a designated distribution from an IRA must report the distribution on Form 1099-R. A distribution from a SIMPLE IRA is a designated distribution from an IRA and thus must be reported on Form 1099-R. The Service has revised Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-sharing Plans, IRAs, Insurance Contracts, Etc., to reflect the requirements that apply to SIMPLE IRAs. The penalty, under the Code, for failure to report a designated distribution from an IRA (including a SIMPLE IRA) is determined under sections 6721-6724.

Q. H-5: Is a SIMPLE IRA trustee responsible for reporting whether a distribution to a participant occurred during the 2-year period described in Q&A I-2?

A. H-5: Yes. A SIMPLE IRA trustee is required to report on Form 1099-R whether a distribution to a participant occurred during the 2-year period described in Q&A I-2. A trustee is permitted to prepare this report on the basis of its own records with respect to the SIMPLE IRA account. A trustee may, but is not required to, take into account other adequately substantiated information regarding the date on which an individual first participated in any SIMPLE IRA Plan maintained by the individual's employer. See Q&A I-2 on the effect of distributions within this 2-year period.

I. TAX TREATMENT OF SIMPLE IRA PLANS

Q. I-1: What are the tax consequences of SIMPLE IRA Plan contributions?

A. I-1: Contributions to a SIMPLE IRA are excludable from federal income tax and not subject to federal income tax withholding. Salary reduction contribu-

tions to a SIMPLE IRA are subject to tax under the Federal Insurance Contributions Act ("FICA"), the Federal Unemployment Tax Act ("FUTA"), and the Railroad Retirement Act ("RRTA"), and must be reported on Form W-2, Wage and Tax Statement. Matching and nonelective contributions to a SIMPLE IRA are not subject to FICA, FUTA, or RRTA taxes, and are not required to be reported on Form W-2.

Q. I-2: What are the tax consequences when amounts are distributed from a SIMPLE IRA?

A. I-2: Generally, the same tax results apply to distributions from a SIMPLE IRA as to distributions from a regular IRA (i.e., an IRA described in § 408(a) or (b)). However, a special rule applies to a payment or distribution received from a SIMPLE IRA during the 2-year period beginning on the date on which the individual first participated in any SIMPLE IRA Plan maintained by the individual's employer (the "2-year period").

Under this special rule, if the additional income tax on early distributions under § 72(t) applies to a distribution within this 2-year period, § 72(t)(6) provides that the rate of additional tax under this special rule is increased from 10 percent to 25 percent. If one of the exceptions to application of the tax under § 72(t) applies (e.g., for amounts paid after age 59½, after death, or as part of a series of substantially equal payments), the exception also applies to distributions within the 2-year period and the 25-percent additional tax does not apply.

Q. I-3: Are there any special rollover rules that apply to a distribution from a SIMPLE IRA?

A. I-3: Section 408(d)(3)(G) provides that the rollover provisions of § 408(d)(3) apply to a distribution from a SIMPLE IRA during the 2-year period described in Q&A I-2 only if the distribution is paid into another SIMPLE IRA. Thus, a distribution from a SIMPLE IRA during that 2-year period qualifies as a rollover contribution (and thus is not includable in gross income) only if the distribution is paid into another SIMPLE IRA and satisfies the other requirements of § 408(d)(3) for treatment as a rollover contribution.

Q. I-4: Can an amount be transferred from a SIMPLE IRA to another IRA in a tax-free trustee-to-trustee transfer?

A. I-4: During the 2-year period described in Q&A I-2, an amount in a SIMPLE IRA can be transferred to another SIMPLE IRA in a tax-free trustee-to-trustee transfer. If, during this 2-year period, an amount is paid from a SIMPLE IRA directly to the trustee of an IRA that is not a SIMPLE IRA, the payment is neither a tax-free trustee-to-trustee transfer nor a rollover contribution; the payment is a distribution from the SIMPLE IRA and a contribution to the other IRA that does not qualify as a rollover contribution. After the expiration of the 2-year period, an amount in a SIMPLE IRA can be transferred in a tax-free trustee-to-trustee transfer to an IRA that is not a SIMPLE IRA.

Q. I-5: When does the 2-year period described in Q&A I-2 begin?

A. I-5: The 2-year period described in Q&A I-2 begins on the first day on which contributions made by the individual's employer are deposited in the individual's SIMPLE IRA.

Q. I-6: Do the qualification rules of § 401(a) apply to contributions under a SIMPLE IRA Plan?

A. I-6: None of the qualification rules of § 401(a) apply to SIMPLE IRA Plans. For example, the § 415 and 416 rules do not apply to contributions under a SIMPLE IRA Plan. Similarly, the § 401(a)-(17) limit does not apply to salary reduction contributions and matching contributions. However, as noted in Q&A D-6, the amount of compensation that may be taken into account for purposes of the 2-percent nonelective contribution is limited to the amount that may be taken into account under § 401(a)(17) for the year.

Q. I-7: What rules apply to an employer's ability to deduct contributions under a SIMPLE IRA Plan?

A. I-7: Pursuant to § 404(m), contributions under a SIMPLE IRA Plan are deductible in the taxable year of the employer with or within which the calendar year for which contributions were made ends (without regard to the limitations of § 404(a)). For example, if an employer has a June 30 taxable year end, contributions under the SIMPLE IRA Plan for the calendar year 1997 (including contributions made in 1997 before June 30, 1997) are deductible in the taxable year ending June 30, 1998. Contributions will be treated as made for a particular taxable

year if they are made on account of that taxable year and are made by the due date (including extensions) prescribed by law for filing the return for the taxable year.

J. EXCEPTION FOR USE OF DESIGNATED FINANCIAL INSTITUTION

Q. J-1: Can an employer designate a particular financial institution to which all contributions under the SIMPLE IRA Plan will be made?

A. J-1: Yes. In accordance with § 408(p)(7), instead of making SIMPLE IRA Plan contributions to the financial institution selected by each eligible employee (see Q&A E-4), an employer may require that all contributions on behalf of all eligible employees under the SIMPLE IRA Plan be made to SIMPLE IRAs at a particular financial institution if the following requirements are met: (1) the employer and the financial institution agree that the financial institution will be a designated financial institution under § 408(p)(7) ("DFI") for the SIMPLE IRA Plan; (2) the financial institution agrees that, if a participant so requests, the participant's balance will be transferred without cost or penalty to another SIMPLE IRA (or, after the 2-year period described in Q&A I-2, to any IRA) at a financial institution selected by the participant; and (3) each participant is given written notification describing the procedures under which, if a participant so requests, the participant's balance will be transferred without cost or penalty to another SIMPLE IRA (or, after the 2-year period described in Q&A I-2, to any IRA) at a financial institution selected by the participant.

This Q&A J-1 is illustrated by the following examples:

Example 1: A representative of Financial Institution L approaches Employer B concerning the establishment of a SIMPLE IRA Plan. Employer B agrees to establish a SIMPLE IRA Plan for its eligible employees. Employer B would prefer to avoid writing checks to more than one financial institution on behalf of employees, and is interested in making all contributions under the SIMPLE IRA Plan to a single financial institution. Employer B and Financial Institution L agree that Financial Institution L will be a DFI and Financial Institution L agrees that, if a par-

ticipant so requests, it will transfer the participant's balance, without cost or penalty, to another SIMPLE IRA (or, after the 2-year period described in Q&A I-2, to any IRA) at a financial institution selected by the participant. A SIMPLE IRA is established for each participating employee of Employer B at Financial Institution L. Each participant is provided with a written description of how and when the participant may direct that the participant's balance attributable to contributions made to Financial Institution L be transferred without cost or penalty to a SIMPLE IRA (or, after the 2-year period described in Q&A I-2, to any IRA) at another financial institution selected by the participant. Financial Institution L is a DFI, and Employer B may require that all contributions on behalf of all eligible employees be made to SIMPLE IRAs at Financial Institution L.

Example 2: A representative of Financial Institution M approaches Employer C concerning the establishment of a SIMPLE IRA Plan. Employer C invites Financial Institution M to make a presentation on its investment options for SIMPLE IRAs to Employer C's employees. Each eligible employee receives notification that the employer must permit the employee to select which financial institution will serve as the trustee of the employee's SIMPLE IRA (see Q&A G-1). All eligible employees of Employer C voluntarily select Financial Institution M to serve as the trustee of the SIMPLE IRAs to which Employer C will make all contributions on behalf of the employees. Financial Institution M is not a DFI merely because all eligible employees of Employer C selected Financial Institution M to serve as the trustee of their SIMPLE IRAs and Employer C consequently makes all contributions to Financial Institution M. Therefore, Financial Institution M is not required to transfer SIMPLE IRA balances without cost or penalty.

Example 3: Assume the same facts as Example 2, except that Employee X and Employee Y, who made salary reduction elections, failed to establish SIMPLE IRAs to receive SIMPLE IRA Plan contributions on their behalf before the first date on which Employer C is required to make a contribution to their SIMPLE IRAs. Employer C establishes SIMPLE

IRAs at Financial Institution M for these employees and contributes the amount required to their accounts. Financial Institution M is not a DFI merely because Employer C establishes SIMPLE IRAs on behalf of Employee X and Employee Y while all other employees voluntarily select Financial Institution M to serve as the trustee of the SIMPLE IRAs to which Employer C will make contributions on their behalf.

Q. J-2: May the time and manner in which a participant may transfer his or her balance without cost or penalty be limited without violating the requirements of § 408(p)(7)?

A. J-2: Yes. Section 408(p)(7) will not be violated merely because a participant is given only a reasonable period of time each year in which to transfer his or her balance without cost or penalty. A participant will be deemed to have been given a reasonable period of time in which to transfer his or her balance without cost or penalty if, for each calendar year, the participant has until the end of the 60-day period described in Q&A E-1 to request to transfer, without cost or penalty, his or her balance attributable to SIMPLE IRA Plan contributions for the calendar year following that 60-day period (or, for the year in which an employee becomes eligible to make salary reduction contributions, for the balance of that year) and subsequent calendar years.

If the time or manner in which a participant may transfer his or her balance without cost or penalty is limited, any such limitation must be disclosed as part of the written notification described in Q&A J-1. In the case of a SIMPLE IRA Plan established using Form 5305-SIMPLE, if the summary description requirement is being satisfied by providing a completed copy of pages one and two of Form 5305-SIMPLE, Article VI (Procedures for Withdrawal) must contain a clear explanation of any such limitation.

This Q&A J-2 is illustrated by the following examples:

Example 1: Employer A first establishes a SIMPLE IRA Plan effective January 1, 1998, and intends to make all contributions to Financial Institution M, which has agreed to serve as a DFI. For the 1998 calendar year, Employer A provides the 60-day election period described in Q&A E-1 beginning November 2,

1997, and notifies each participant that he or she may request that his or her balance attributable to future contributions be transferred from Financial Institution M to a SIMPLE IRA at a financial institution that the participant selects. The notification states that the transfer will be made without cost or penalty if the participant contacts Financial Institution M prior to January 1, 1998. For the 1998 calendar year, the requirements of § 408(p)(7) will not be violated merely because participants are given only a 60-day period in which to request to transfer their balances without cost or penalty.

Example 2: Assume the same facts as Example 1. Participant X does not request a transfer of her balance by December 31, 1997, but requests a transfer of her current balance to another SIMPLE IRA on July 1, 1998. Participant X's current balance would not be required to be transferred without cost or penalty because Participant X did not request such a transfer prior to January 1, 1998. However, during the 60-day period preceding the 1999 calendar year, Participant X may request a transfer, without cost or penalty, of her balance attributable to contributions made for the 1999 calendar year and, if she so elects, for all future calendar years (but not her balance attributable to contributions for the 1998 calendar year).

Example 3: Assume the same facts as Example 1. Under the terms of the SIMPLE IRA Plan, Participant Y becomes an eligible employee on June 1, 1998, and, for Participant Y, the 60-day period described in Q&A E-1 begins on that date. For the 1998 calendar year, Participant Y will be deemed to have been given a reasonable amount of time in which to request to transfer, without cost or penalty, his balance attributable to contributions for the balance of the 1998 calendar year if Financial Institution M allows such a request to be made prior to July 31, 1998.

Q. J-3: Is there a limit on the frequency with which a participant's balance must be transferred without cost or penalty?

A. J-3: In order to satisfy § 408(p)(7), if a participant acts, within applicable reasonable time limits, if any, to request a transfer of his or her balance, the participant's balance must be transferred on a reasonably frequent basis. A participant's balance will be deemed to be transferred

on a reasonably frequent basis if it is transferred on a monthly basis.

Q. J-4: How does a DFI transfer a participant's balance without cost or penalty?

A. J-4: In order to satisfy § 408(p)(7), a participant's balance must be transferred in a trustee-to-trustee transfer directly to a SIMPLE IRA (or, after the 2-year period described in Q&A I-2, to any IRA) at the financial institution specified by the participant.

A transfer is deemed to be made without cost or penalty if no liquidation, transaction, redemption or termination fee, or any commission, load (whether front-end or back-end) or surrender charge, or similar fee or charge is imposed with respect to the balance being transferred. A transfer will not fail to be made without cost or penalty merely because contributions that a participant has elected to have transferred without cost or penalty are required to be invested in one specified investment option until transferred, even though a variety of investment options are available with respect to contributions that participants have not elected to transfer.

This Q&A J-4 is illustrated by the following examples:

Example 1: Financial Institution Q agrees to be a DFI for the SIMPLE IRA Plan maintained by Employer D. Employer D provides the 60-day election period described in Q&A E-1 beginning on November 2 of each year and each participant is notified that he or she may request, before the end of the 60-day period, a transfer of his or her future contributions from Financial Institution Q without cost or penalty to a SIMPLE IRA (or, after the 2-year period described in Q&A I-2, to any IRA) at a financial institution selected by the participant. The notification states that a participant's contributions that are to be transferred without cost or penalty will be invested in a specified investment option and will be transferred to the financial institution selected by the participant on a monthly basis.

Financial Institution Q offers various investment options to account holders of SIMPLE IRA accounts, including investment options with a sales charge. Any participant who does not elect to have his or her balance transferred to another financial institution may invest the contributions made on his or her behalf in any investment option available to account

holders of SIMPLE IRA accounts at Financial Institution Q. However, contributions that a participant has elected to have transferred are automatically invested, prior to transfer, in a specified investment option that has no sales charge. The requirement that a participant's balance be transferred without cost or penalty will not be violated merely because contributions that have been designated to be transferred pursuant to a participant's election are automatically invested in one specified investment option and transferred on a monthly basis to the financial institution selected by the participant.

Example 2: Assume the same facts as in Example 1. Financial Institution Q generally charges its IRA accounts a reasonable annual administration fee. Financial Institution Q also charges this annual administration fee with respect to SIMPLE IRA accounts, including SIMPLE IRA accounts from which balances must be transferred in accordance with participants' transfer elections. The requirement that participants' balances be transferred without cost or penalty will not be violated merely because a reasonable annual administration fee is charged to SIMPLE IRA accounts from which balances must be transferred in accordance with participants' transfer elections.

Q. J-5: Is the "without cost or penalty" requirement violated if a DFI charges an employer for a participant's transfer of his or her balance?

A. J-5: The "without cost or penalty" requirement of § 408(p)(7) is not violated merely because a DFI charges an employer an amount that takes into account the financial institution's responsibility to transfer balances upon a participant's request or otherwise charges an employer for a transfer requested by a participant, provided that the charge is not passed through to the participant who requests the transfer.

K. SIMPLE IRA PLAN ESTABLISHMENT

Q. K-1: Must an employer establish a SIMPLE IRA Plan on January 1?

A. K-1: An existing employer may establish a SIMPLE IRA Plan effective on any date between January 1 and October 1 of a year beginning after December 31, 1996, provided that the employer (or

any predecessor employer) did not previously maintain a SIMPLE IRA Plan. This requirement does not apply to a new employer that comes into existence after October 1 of the year the SIMPLE IRA Plan is established if the employer establishes the SIMPLE IRA Plan as soon as administratively feasible after the employer comes into existence. If an employer (or predecessor employer) previously maintained a SIMPLE IRA Plan, the employer may establish a SIMPLE IRA Plan effective only on January 1 of a year.

Q. K-2: When must a SIMPLE IRA be established for an employee?

A. K-2: A SIMPLE IRA is required to be established for an employee prior to the first date by which a contribution is required to be deposited into the employee's SIMPLE IRA (see Q&As G-5 and G-6).

Q. K-3: Has the Service issued model forms that an employer can use to establish a SIMPLE IRA Plan?

A. K-3: Yes. On October 31, 1996, the Service issued Form 5305-SIMPLE (for Use With a Designated Financial Institution), which is a form that may be used by an employer establishing a SIMPLE IRA Plan with a financial institution that is a DFI. On December 30, 1996, the Service issued Form 5304-SIMPLE (Not Subject to the Designated Financial Institution Rules), which is the model form that may be used by an employer to establish a SIMPLE IRA Plan that does not use a DFI.

Q. K-4: How long may an employer use the modified Form 5305-SIMPLE (for Use With a Designated Financial Institution)?

A. K-4: An employer that established or establishes a SIMPLE IRA Plan (that does not use a DFI) by using Form 5305-SIMPLE (for Use With a Designated Financial Institution) as modified in accordance with Q&A K-3 as it originally appeared in Notice 97-6 may continue to use that modified form through the end of 1998. The Service has not approved the use of the modified form beyond 1998. Consequently, such an employer that makes contributions for a calendar year after 1998 must adopt one of the two model forms (Form 5304-SIMPLE or Form 5305-SIMPLE) or an approved prototype SIMPLE IRA Plan in order to rely

on Service-approved SIMPLE IRA Plans for 1999 and future years. For purposes of Q&As E-4, G-1 and H-1 of this notice, the modified Form 5305-SIMPLE is treated as a Form 5304-SIMPLE (Not Subject to the Designated Financial Institution Rules).

EFFECT ON OTHER DOCUMENTS

This notice modifies and supersedes Notice 97-6.

PAPERWORK REDUCTION ACT

The collection of information contained in this notice has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1502.

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

The collection of information in this notice is in the sections headed "EMPLOYEE ELECTIONS" and "EMPLOYER ADMINISTRATIVE AND NOTIFICATION REQUIREMENTS." This information is required to assure compliance with the new provisions of the Small Business Job Protection Act of 1996. The collection of information is required to obtain a benefit. The likely respondents are individuals, businesses or other for-profit institutions, and not-for-profit institutions.

The estimated total annual reporting burden is 75,000 hours. The estimated annual burden per recordkeeper is 15 minutes. The estimated number of respondents is 300,000. The estimated annual frequency of responses is on occasion.

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

DRAFTING INFORMATION

The principal author of this notice is Roger Kuehnle of the Employee Plans Division. For further information regarding

this notice, please contact the Employee Plans Division's taxpayer assistance telephone service at (202) 622-6074/6075 (not toll-free numbers), between the hours of 1:30 and 3:30 p.m. Eastern Time, Monday through Thursday.

Rev. Proc. 98-10

26 CFR 601.201: Rulings and determination letters. (Also, Part I, § 412.)

Section 1. Purpose and Scope

This revenue procedure modifies Rev. Proc. 95-51, 1995-2 C.B. 431, which provides approval to change the funding method (actuarial cost method) used for a defined benefit pension plan. Specifically, this revenue procedure modifies § 3 of Rev. Proc. 95-51 to provide approval to change the asset valuation method to one of three additional methods and to provide approval for certain changes in valuation software. This revenue procedure also clarifies and modifies other provisions of Rev. Proc. 95-51.

Section 2. Background

.01 Section 412(c)(5)(A) of the Internal Revenue Code, as amended, and § 302(c)(5)(A) of the Employee Retirement Income Security Act of 1974 (ERISA), as amended, state that if the funding method of a plan is changed, the new funding method shall become effective only if the change is approved by the Secretary.

.02 Section 1.412(c)(2)-1 of the Income Tax Regulations generally provides that a change in the actuarial valuation method used to value the assets of a plan is a change in funding method that requires approval under § 412(c)(5) of the Code.

.03 Rev. Proc. 95-51 provides approval for certain changes in funding method. Section 3 of Rev. Proc. 95-51 provides approval for changes to 14 specific methods including three asset valuation methods. Section 4 of Rev. Proc. 95-51 provides four special approvals for changes. Section 5 of Rev. Proc. 95-51 provides rules relating to the establishment and maintenance of amortization bases upon changing methods. Section 6 of Rev. Proc. 95-51 provides restrictions under the revenue procedure.

Section 3. Additional Approvals under Rev. Proc. 95-51

.01 Section 3 of Rev. Proc. 95-51 (Approval for Specified Changes) is modified by adding the following:

.15 *Approval 15.* Approval is granted for a change in asset valuation method to the smoothed market value (without phase-in) described below, or to any alternative formulation that is algebraically equivalent to this smoothed value. The asset value determined under the method will be adjusted to be no greater than 120% and no less than 80% of the fair market value defined in § 1.412(c)(2)-1(c).

Under this method, the actuarial value of assets is equal to the market value of assets less a decreasing fraction (i.e., $(n-1)/n$, $(n-2)/n$, etc., where n equals the number of years in the smoothing period) of the gain or loss for each of the preceding $n-1$ years. The stated smoothing period may not exceed five (5) plan years.

Under this method, a gain or loss for a year is determined by calculating the difference between the expected value of the assets for the year and the market value of the assets at the valuation date. The expected value of the assets for the year is the market value of the assets at the valuation date for the prior year brought forward with interest at the valuation interest rate to the valuation date for the current year plus contributions minus benefit disbursements, all adjusted with interest at the valuation rate to the valuation date for the current year. If the expected value is less than the market value, the difference is a gain. Conversely, if the expected value is greater than the market value, the difference is a loss.

For example, if the smoothing period is five years, the actuarial value of the assets will be the market value of the plan's assets, with gains subtracted or losses added at the rates described as follows:

- (i) 4/5 of the prior year's gain or loss
- (ii) 3/5 of the second preceding year's gain or loss
- (iii) 2/5 of the third preceding year's gain or loss
- (iv) 1/5 of the fourth preceding year's gain or loss

.16 *Approval 16.* Approval is granted for a change in asset valuation method to the smoothed market value (with phase-in) described below, or to any alternative

formulation that is algebraically equivalent to this smoothed value. The asset value determined under the method will be adjusted to be no greater than 120% and no less than 80% of the fair market value defined in § 1.412(c)(2)-1(c).

In the first year this method is used the actuarial value of assets is equal to the market value as of the valuation date. In each subsequent year, the smoothed value is calculated in the same manner as in Approval 15, except that the only gains or losses recognized are those occurring in the year of the change and in later years. The stated smoothing period may not exceed five (5) plan years.

.17 *Approval 17.* Approval is granted for a change in asset valuation method to the average value (as defined in § 1.412(c)(2)-1(b)(7)), modified to use the alternative phase-in as described below, or to any alternative formulation that is algebraically equivalent to this average. The asset value determined under the method will be adjusted to be no greater than 120% and no less than 80% of the fair market value defined in § 1.412(c)(2)-1(c).

In the first year this method is used, the actuarial value of assets is equal to the market value. In the second year, the average value is calculated in the same manner as in Approval 11, except that the averaging period is two years. In the third year, the average value is calculated in the same manner as in Approval 11, except that the averaging period is three years. This process continues until the stated averaging period (not to exceed five years) is reached.

.02 Section 4 of Rev. Proc. 95-51 (Special Approvals) is modified to add a new § 4.05 as follows:

.05 Approval for Change in Valuation Software

(1) Approval is granted for a change in method that results from a change in valuation software where all the conditions set forth in paragraphs (2) through (8) are satisfied. Note that certain changes in valuation software may not constitute changes in funding method. For example, the update of the valuation software to incorporate the actual social security taxable wage base for the current year is not a change in funding method. Also, if all of the results of each specific computation are the same after the change in valuation

software, there is no change in funding method.

(2) There has been a modification to the computations in the valuation software or a different valuation software system has been used. Examples of modifications to the computations in the valuation software include a change from commutation functions to direct calculation of actuarial values, changes in the rounding conventions or changes to correct errors or inefficiencies in the computations. Examples of using a different valuation software system include a change in the spreadsheet software (e.g., Lotus 1-2-3 to Excel) or a change in the actuarial software vendor.

(3) The underlying method is unchanged and is consistent with the information contained in the prior actuarial valuation reports and prior Schedules B of Form 5500.

(4) The modification to the computations in the valuation software or the use of a different valuation software system is designed to produce results that are no less accurate than the results produced prior to the modification or change.

(5) The net charge to the funding standard account for the year does not differ from the net charge that would result if the valuation software had not been changed (all other factors being held constant) by more than two percent (2%).

(6) A change in valuation software requiring approval was not made for the prior plan year.

(7) Section 4.04 (Approval for Takeover Plans) of this revenue procedure is not applicable to the change.

(8) The effect of the change in method is treated in the same manner as an experience gain or loss, unless the actuarial assumptions are being changed, in which case the effect of the change in method is treated as part of the effect of the change in assumptions.

Section 4. Clarifications and Modifications of Rev. Proc. 95-51

.01 Section 3.11 of Rev. Proc. 95-51 is clarified to read as follows:

.11 *Approval 11.* Approval is granted for a change in asset valuation method to the average value as defined in § 1.412(c)(2)-1(b)(7) (which does not have a phase-in), or to any alternative for-

mulation that is algebraically equivalent to this average value. The asset value determined under the method will be adjusted to be no greater than 120% and no less than 80% of the fair market value defined in § 1.412(c)(2)-1(c).

For example, under § 1.412(c)(2)-1(b)(7), if the averaging period is five years, the average value is based on the fair market value of assets in the current year and the adjusted values of assets for the prior four years as provided in § 1.412(c)(2)-1(b)(8). An alternative formulation which is algebraically equivalent to this method is one in which the average value of assets is equal to the fair market value on the valuation date, minus decreasing fractions (4/5, 3/5, 2/5 and 1/5, in this example) of the appreciation and depreciation of the assets in each of the four preceding years. The stated averaging period may not exceed five (5) plan years.

.02 Section 3.11 of Rev. Proc. 95-51 is clarified to read as follows:

.12 *Approval 12.* Approval is granted for a change in asset valuation method to the average value (as defined in § 1.412(c)(2)-1(b)(7)), modified to use the phase-in described below, or to any alternative formulation that is algebraically equivalent to this average value. The asset value determined under the method will be adjusted to be no greater than 120% and no less than 80% of the fair market value defined in § 1.412(c)(2)-1(c).

In the first year this method is used, the average value is calculated as in Approval 11, except that the adjusted values for all but the most recent prior year are replaced by the adjusted value for the most recent prior year. In the second year, the average is calculated as in Approval 11, except that the values for all but the most recent two prior years are replaced by the adjusted value for the second most recent prior year. This process is continued until values for all prior years in the averaging period are phased in. The stated averaging period may not exceed five (5) plan years.

.03 Section 4.02(1) of Rev. Proc. 95-51 is modified to read as follows:

(1) If a plan uses an individual aggregate funding method and an individual normal cost becomes negative for a participant, approval is granted to re-allocate excess assets to other participants in proportion to the present value of accrued

benefits, or in proportion to the accrued liability determined under the immediate gain funding method described in § 3.01, § 3.08 (only if the normal cost for a participant is determined as a level percent of compensation under the plan's method), or § 3.09 (only if the normal cost for a participant is determined as a level dollar amount under the plan's method) or in proportion to the allocated adjusted assets prior to the reallocation. For this purpose, excess assets are defined as the excess, if any, of the assets currently allocated to the participant over the present value of the participant's future benefits.

.04 Section 4.04(3) of Rev. Proc. 95-51 is modified to read as follows:

(3) The method used by the new actuary is substantially the same as the method used by the prior actuary, and is consistent with the information contained in the prior actuarial valuation reports or prior Schedules B of Form 5500. Also, the method used by the new actuary must be applied to the prior year (using the assumptions of the prior actuary) and the absolute value of each resulting difference in normal cost, accrued liability (if directly computed under the method) and actuarial value of assets, that is attributable to the change in cost method, does not exceed five percent (5%) of the respective amounts calculated by the prior actuary for that year.

.05 Section 5.01(2) (Creation of a Funding Method Change Base) of Rev. Proc. 95-51 is modified to read as follows:

Except in the case of a change to a funding method described in § 3.02, § 3.03, § 3.04, or § 3.05, all existing bases shall be maintained and an amortization base shall be established equal to the difference between the unfunded accrued liability under the new method and an amount equal to (A) the net sum of the outstanding balances of all amortization bases (including, when the preceding method was an immediate gain method, the gain or loss base for the immediately preceding period), treating credit bases as negative bases, less (B) the credit balance (or plus the funding deficiency), if any, in the funding standard account, less (C) the sum of (i) any existing accumulation of additional funding charges for prior plan years due to § 412(l), (ii) any existing accumulation of additional interest charges due to late or unpaid quarterly install-

ments for prior plan years and (iii) any existing accumulation of additional interest charges due to the amortization of prior funding waivers (which sum can be found on the Schedule B, for example, in 1997 on Line 9q(4)), all adjusted for interest at the valuation rate to the valuation date in the plan year for which the change is made. If this difference is a positive or negative number, the resulting base will be a charge base or a credit base, respectively. In the case of a change to a funding method described in § 3.02, § 3.03, § 3.04, or § 3.05, (a) the bases described in paragraph (1) must be maintained, and (b) all amortization bases other than those described in paragraph (1) shall be considered fully amortized.

.06 Section 5.01 of Rev. Proc. 95-51 is modified by adding the following:

(5) If the funding method is being changed in accordance with the approval provided in § 4.01 (Approval to Anticipate Scheduled Benefit Increases), no base is established due solely to the change in method. The entire increase in unfunded liability resulting from anticipation of benefit increases scheduled to take effect during the term of the collective bargaining agreement currently applicable to the plan is treated as resulting from a plan amendment and the base established in the funding standard account is amortized over a 30-year period.

.07 Section 6.01(2) of Rev. Proc. 95-51 (Administrator Approval) is modified to read as follows:

(2) This revenue procedure does not apply unless the plan administrator

(within the meaning of § 414(g)) or an authorized representative of the plan sponsor indicates as part of the series Form 5500 for the plan year for which the change is effective that the plan administrator or plan sponsor agrees to the change in funding method. However, in the case of a change in funding method described in § 4.01 (Approval to Anticipate Scheduled Benefit Increases), the plan administrator or authorized representative does not need to agree to the request.

.08 Section 6.02(3)(c) of Rev. Proc. 95-51 (Four-year limitation on changes) is clarified and modified to read as follows:

(c) The funding method is being changed in a way not described in (a) or (b), and a funding method change (other than a change for which approval is provided by § 4 of this revenue procedure, or a change described in (a) or (b)) was made in any of the four (4) preceding plan years.

Section 5. Effective Date

.01 In general, this revenue procedure is effective for plan years commencing on or after January 1, 1997.

.02 For plan years beginning in 1997, § 4.04(3) of Rev. Proc. 95-51 may be applied as originally issued or as modified by § 4.04 of this revenue procedure.

.03 The modification made by § 4.05 of this revenue procedure to § 5.01(2) of Rev. Proc. 95-51 (Creation of a funding method change base) is effective only for plan years commencing on or after January 1, 1998.

.04 If the funding method for the plan

was changed in accordance with § 4.01 of Rev. Proc. 95-51 (Approval to anticipate scheduled benefit increases) as originally issued and the amortization period for the amortization base established as a result of the method change was 10 years, the plan sponsor may either, (1) retain the 10 year period, or (2) file an amended Schedule B for the year of the change and for any subsequent years reflecting a 30 year amortization period for such base.

Section 6. Effect on Other Revenue Procedures

Rev. Proc. 95-51 is clarified and modified.

Section 7. Comments Requested Concerning Mergers

The Service requests written comments concerning potential standard procedures that can be used for a change in funding method in connection with a plan spin-off or merger. Comments and information should be sent to: Commissioner of the Internal Revenue Service, Attention: CP:E:EP:A:1, Washington, DC 20224.

Drafting Information

The principal author of this revenue procedure is Todd Newman of the Employee Plans Division. For further information regarding this revenue procedure, call (202) 622-6076 between 2:30 and 3:30 Eastern time (not a toll free number) Monday through Thursday. Mr. Newman's number is (202) 622-6262 (also not a toll free number).

Part IV. Items of General Interest

Employee Plans; Examination Guidelines

Announcement 98-1

The Internal Revenue Service has developed proposed examination guidelines for employee plans examiners to use when examining issues relating to employer deductions under § 404 of the Internal Revenue Code and the minimum funding standards under § 412. The guidelines provide technical background and guidance as to issues that should be considered during an examination. The guidelines are not intended to be all inclusive, and may be modified based on specific issues encountered by the examiners during an examination.

As with earlier examination guidelines, the Service is seeking public comments on the proposed guidelines before they are finalized for the Internal Revenue Manual.

Copies of these guidelines have been made available to the tax reporting services. The guidelines are also available from the Service. Requests for a copy of the examination guidelines may be submitted in writing to the following address:

Internal Revenue Service
Assistant Commissioner (Employee Plans and Exempt Organizations)
Attention: CP:E:EP:FC Room 2236
Washington, DC 20224

Written comments on the guidelines may be submitted to the above address on or before April 13, 1998 to the above address.

Items of General Interest

Form 8023 To Replace Form 8023-A

Announcement 98-2

New Form 8023, Election Under Section 338 for Corporations Making Quali-

fied Stock Purchases, is available. It replaces Form 8023-A, Corporate Qualified Stock Purchases. Taxpayers can use new Form 8023 to make elections under section 338 of the Internal Revenue Code with respect to any qualified stock purchase ("QSP") (as defined at section 338(d)(3)) occurring after 1996. For elections under section 338 with respect to any QSP occurring during 1997, taxpayers may use either the new Form 8023 or the old Form 8023-A. New Form 8023 can be downloaded from the Internet or the Internal Revenue Information Services, using a computer and modem, or ordered by telephone, as shown below.

Request by—	Number or Address
Internet:	
World Wide Web	www.irs.ustreas.gov
FTP	ftp.irs.ustreas.gov
Telnet	iris.irs.ustreas.gov
Computer and modem	703-321-8020 (modem settings are N, 8, 1)
Telephone	800-TAX-FORM (800-829-3676)

Deletions from Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 98-3

The names of organizations that no longer qualify as organizations described in section 170(c)(2) of the Internal Revenue Code of 1986 are listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an orga-

nization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on January 12, 1998, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428 (c)(1). For individual contributors, the maximum deduction protected is \$1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Bainbridge Women's Club
Richmond, VA
There to Care, Inc.
Toledo, OH

Definition of Terms

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

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

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

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

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it ap-

plies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

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

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

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the

new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

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

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

Abbreviations

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

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C.—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.

E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contribution Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.

PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Proc.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

Numerical Finding List¹

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¹ A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 1997-27 through 1997-52 will be found in Internal Revenue Bulletin 1998-1, dated January 5, 1998.

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¹ A cumulative finding list for previously published items mentioned in Internal Revenue Bulletins 1997-27 through 1997-52 will be found in Internal Revenue Bulletin 1998-1, dated January 5, 1998.

Notes

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