THE Pension Digest

Published Since 1984

Collin W. Fritz & Associates, Inc., *"The Pension Specialists"*

January, 1990

BUSH ADMINISTRATION CONSIDERING NEW LONG-TERM SAVINGS PLAN

The low rate of personal savings in America has the Bush administration and many Congressmen concerned. As a result, different plans are being studied that would increase the rate of personal savings by Americans. One such plan which is being studied by the Bush Administration would create special, long term savings accounts.

Under the proposed plan, interest on these accounts would be exempt from taxes. Savers would be allowed to withdraw their funds without penalty if the dollars were kept in the accounts for a ten year period. An early withdrawal penalty would be assessed if funds were withdrawn before the ten year period. Up to $5,000 could be deposited in these accounts annually.

Unlike the existing savings plans, such as IRAs and 401(k)s, this proposed plan is not designed specifically to encourage saving for retirement. Encouraging saving in general is the goal.

Currently, this new plan has been dubbed the "family savings plan." While the idea of encouraging saving by taxpayers is generally well-received in Congress, expect substantial disagreement in Congress and between Congress and the President over how to achieve this goal. Don't expect new legislation to be enacted overnight passing these new savings plans.

We will continue to report on further developments with this proposed legislation in The Pension Digest. PD

IRS EXPLAINS 1990 IRA REPORTING CHANGES

As reported in the December Pension Digest, the IRS has announced new reporting requirements for reporting distributions from IRAs and SEPs for 1990. While these reports do not have to be generated until January of 1991, you'll want to review your information gathering on distributions and make sure that your software vendor or data processing vendor will make the necessary changes. You need to make certain you are able to report these distributions accurately.

An "IRA-SEP Checkbox" has been added to box 7 of both the 1099-R and W-2P Forms. You'll simply need to check this box when you are reporting a distribution from an IRA or SEP. Along with marking the checkbox, you'll still need to use a distribution code to identify the type of distribution.

The IRS modifications of these distribution codes are listed in Table B on page two, which compares the 1989 and 1990 distribution codes. To comment on some of these changes, the new Code 1 will only be used when distributions are subject to the 10% premature distribution penalty tax. Code 2 will be used to indicate that an exception to the 10% penalty tax applies. Table A on page 2 compares the 1989 and 1990 coding of the exceptions to the 10% penalty.

The new checkbox to identify that a reported distribution is from a SEP or IRA

Continued

Table "A"

Type of Distribution	1989 Code	1990 Code
— Rollover	2	2
— Disability	3	3
— Death	4	4
— Premature - No Known Exception	1	1
— Premature, Exception Applies	1	2
— Substantially Equal Periodic Payment Exception Applies	1	2

is needed so that the IRS knows that a distribution is not from a Qualified Plan. The W-2P and 1099-R are also used to report distributions from Qualified Plans.

The New Codes

Here are the changes that have been made in the 1990 distribution codes. To help you compare the old and new codes, the 1989 and 1990 rules are presented side by side in Table B. According to Announcement 89-151, "if a code is not mentioned, it will remain substantially the same as it was for 1989."

Must We Purchase New Forms Which Reflect These Changes?

Most IRA custodians use an IRA distribution or withdrawal form to gather information on the distribution, including the code for the "reason for the distributions," and to meet the income tax withholding rules. Many of you have called on the consulting line wondering whether you must update these forms.

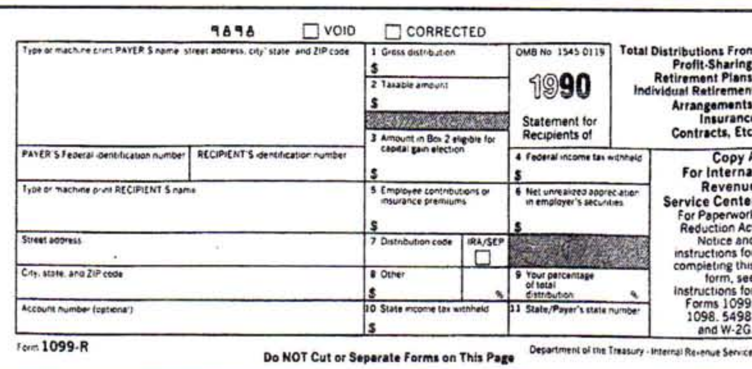
Understand that you are not required to toss away your current supply of forms. AS LONG AS you use the new codes–explained in this article–for 1990 distributions, you could use up your inventory of current forms. Table B compares the 1989 and 1990 requirements, and will help you to make this comparison and use the proper codes.

However, we recommend that you do switch to updated forms, to ensure that you are accurately gathering this information. Collin Fritz and Associates, Ltd. is updating Form #57, "IRA Distribution Form," to reflect these new codes. The new form will be available shortly. PD

Table "B"

Code		1989 to 1990 Comparison
1	*1989 –*	*Premature Distribution(other than codes 2, 3, 4, 8 or P)*
	1990 –	Code 1 has been changed to "Early (premature) distribution, no known exception." Code 1 will be used only if the employee/taxpayer has not reached age 59-1/2, and only if none of the exceptions under section 72(q), (t), or (v) are known to apply.
2	*1989 –*	*Rollover*
	1990 –	Code 2, "Rollover," was eliminated. Code 2 is now "Early (premature) distribution, exception applies (as defined in section 72(q), (t), or (v)." Code 2 will be used only if the employee/taxpayer has not reached age 59-1/2 to indicate that an exception under 72(q), (t), or (v) applies. However, instead of Code 2, Code 3 or 4, whichever applies, will be used for an early distribution due to disability or death.
3	*1989 –*	*Disability*
	1990 –	Substantially the same as in 1989.
4	*1989 –*	*Death*
	1990 –	Code 4, "Death," has not changed. Code 4 will continue to be used regardless of the age of the employee/taxpayer to indicate payment to a beneficiary, including an estate. It will also be used for death benefit payments not made as part of a pension, profit-sharing, or retirement plan.
5	*1989 –*	*Prohibited Transaction (applies only to 1099-R)*
	1990 –	Substantially the same as in 1989.
6	*1989 –*	*Other*
	1990 –	Code 6, "Other," was eliminated. On Form W-2P, there is no Code 6. On Form 1099-R, Code 6 has been changed to "Section 1035 exchange." It will be used on Form 1099-R to indicate the tax-free exchange of insurance contracts under section 1035.
7	*1989 –*	*Normal IRA or SEP Distributions*
	1990 –	Code 7 was changed to "Normal distribution." It will be used for a normal distribution from any plan, including an IRA or SEP, if the employee/taxpayer is at least 59-1/2.
8	*1989 –*	*Excess Contributions/Deferrals Plus Earnings Taxable in 1989*
	1990 –	Substantially the same as in 1989.
"P"	*1989 –*	*Excess Contributions Plus Earnings/Excess Deferrals Taxable in 1988*
	1990 –	Substantially the same as in 1989.
D	*1989 –*	*Excess Contributions Plus Earnings/Excess Deferrals Taxable in 1987*
	1990 –	Substantially the same as in 1989.
9	*1989 –*	*Current Insurance Premiums Including PS58 Costs*
	1990 –	Substantially the same as in 1989.

Sample Form 1099-R


9898 VOID CORRECTED
Type or machine print PAYER'S name, street address, city, state, and ZIP code
1 Gross distribution $
2 Taxable amount $
3 Amount in Box 2 eligible for capital gain election $
OMB No. 1545-0119
1990
Statement for Recipients of
Total Distributions From Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, Insurance Contracts, Etc.
PAYER'S Federal identification number
RECIPIENT'S identification number
4 Federal income tax withheld $
Type or machine print RECIPIENT'S name
5 Employee contributions or insurance premiums $
6 Net unrealized appreciation in employer's securities $
Street address
7 Distribution code
IRA/SEP
City, state, and ZIP code
8 Other $ %
9 Your percentage of total distribution %
Account number (optional)
10 State income tax withheld $
11 State/Payer's state number
Copy A For Internal Revenue Service Center
For Paperwork Reduction Act Notice and instructions for completing this form, see instructions for Forms 1099, 1098, 5498, and W-2G.
Form 1099-R
Do NOT Cut or Separate Forms on This Page
Department of the Treasury - Internal Revenue Service

NEW ACT MEANS LARGER PENALTIES FOR NON-COMPLIANCE WITH IRA REPORTING

The Omnibus Budget Reconcilation Act of 1989 (OBRA) includes numerous new rules and penalties for non-compliance with IRA reporting rules. These rules were once a separate act, "The Improved Penalty and Compliance Act," but the latter act was merged into the Omnibus Budget Reconciliation Act. OBRA also includes new rules affecting certain filers of returns on magnetic media.

This article describes the operation of these new civil penalties affecting IRA information reporting.

The Present Law

Under the rules prior to OBRA, information return reporters that fail to file an information return with the Internal Revenue Service (IRS) by the filing deadline are subject to a $50 penalty for each failure, to a maximum of $100,000 per calendar year. There is also a penalty for failure to furnish information returns to taxpayers of $50 for each failure, to a maximum of $100,000 per calendar year. If all of the required information on an information return is not furnished or if incorrect information is included on the return, this is subject to a $5 per failure penalty, to a maximum of $20,000 per calendar year.

The New Penalty Provisions

1. Failure to File Correct Information Returns

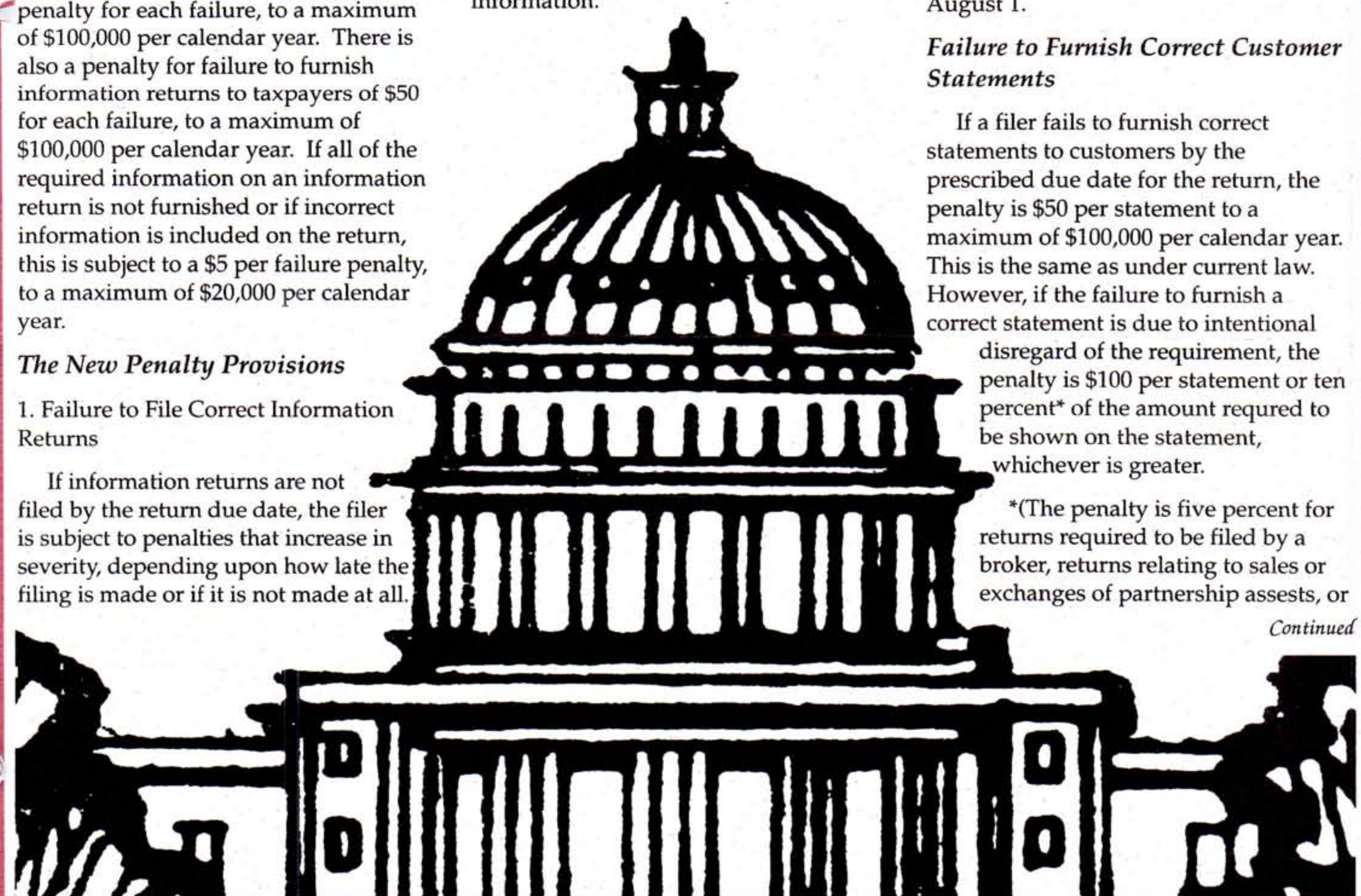
If information returns are not filed by the return due date, the filer is subject to penalties that increase in severity, depending upon how late the filing is made or if it is not made at all.

If a filer files a correct information return after the applicable filing deadline but on or before the date that is thirty days after the filing due date, the penalty is $15 per return to a maximum of $75,000 per calendar year.

If a filer files a correct information return after the date that is thirty days after the filing deadline but on or before August 1, the penalty is $30 per return to a maximum of $150,000 per calendar year. If a correct information return is not filed on or before August 1 of a given year, the penalty is $50 per return to a maximum of $250,000 per calendar year.

The "De Minimus" Exception

There is a special exception for what the drafters call "de minimis" failures to include the required, correct information. This exception applies to returns that are corrected on or before the applicable August 1st deadline. The exception applies if an information return is originally filed without all of the required information or with incorrect information, and the return is corrected on or before August 1, then the original return is treated as having been filed with all of the corrected required information.



(Statement of the Managers, Title VII N.) Not all such returns escape the penalty. This de minimus exception for any calendar year is limited to the greater of (1) ten returns, or (2) one-half of one percent of the total number of information returns that are required to be filed by any one person during the calendar year.

Another Exception: The Small Business Exception

Another exception to the increased three-tier penalties is called the small business exception. Small businesses are considered to be firms having average annual gross receipts for the three most recent tax years of $5,000,000 or less. The maximum penalties paid by small businesses are as follows:

(1) $25,000 instead of $75,000 if the failures are corrected within the first thirty days after the due date of the return;

(2) $50,000 instead of $150,000 if the failures are corrected on or before August 1; and

(3) $100,000 instead of $250,000 if the failures are not corrected on or before August 1.

Failure to Furnish Correct Customer Statements

If a filer fails to furnish correct statements to customers by the prescribed due date for the return, the penalty is $50 per statement to a maximum of $100,000 per calendar year. This is the same as under current law. However, if the failure to furnish a correct statement is due to intentional disregard of the requirement, the penalty is $100 per statement or ten percent* of the amount requred to be shown on the statement, whichever is greater.

*(The penalty is five percent for returns required to be filed by a broker, returns relating to sales or exchanges of partnership assests, or

Continued

returns relating to disposing of donated property.)

NOTE: There is no limit on the maximum penalty per calendar year for intentional disregard of this filing requirement.

Magnetic Media Reporting

Section 7713 of The Revenue Reconciliation Act is called "Uniform Requirements for Returns on Magnetic Media." This section states, in part, as follows:

"(1) IN GENERAL.—The Secretary shall prescribe regulations providing standards for determining which returns must be filed on magnetic media or in other machine-readable form. The Secretary may not require returns of any tax imposed by subtitle A on individuals, estates, and trusts to be other than on paper forms supplied by the Secretary—

"(2) REQUIREMENTS OF REGULATIONS.—In prescribing regulations under paragraph (1), the Secretary—

"(A) shall not require any person to file returns on magnetic media unless such person is required to file at least 250 returns during the calendar year, and

"(B) shall take into account (among other relevant factors) the ability of the taxpayer to comply at reasonable cost with the requirements of such regulations."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to returns the due date for which (determined without regard to extensions) is after December 31, 1989.

The Statement of the Managers has the following to say about this provision:

Uniform Requirements For
Returns On Magnetic Media

The House bill provides that uniform magnetic media requirements apply to all information returns filed during any calendar year. The bill accomplishes this by making statutory the requirement currently contained in IRS regulations that persons filing more than 250 information returns file those returns on magnetic media. The bill makes this requirement applicable to all types of information returns. Thus, the bill repeals the provision of present law that requires persons filing more than 50 information returns relating to payments of interest, dividends, and patronage dividends to file all such returns on magnetic media. The bill provides that the penalty for failing to file information returns on magnetic media when required to do so applies only to the number required to be so filed that exceeds 250. The penalties for failure to file on a timely basis correct information returns would apply to the first 250 returns.

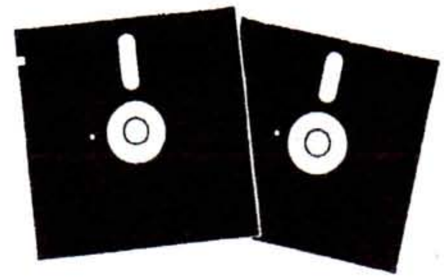
One commentary on this provision of the new Act interprets this provision to mean that if a filer files 250 or more information returns for a calendar year, the filer must file using magnetic media. This commentary states as follows:

"The Committee Report indicates that this requirement "is applicable to all types of information returns." Thus, it can be concluded that the 250-return requirement is to be applied on the basis of the total or aggregate number of information returns filed during the calendar year, rather than on the basis of the total number of each type of information return as is required by Reg. § 301.6011-2(b). Further, the special provision requiring magnetic media filing for more than 50 information returns for interest, dividends and patronage dividends (determined on an aggregate basis) has been repealed."

Based upon our reading of the Act and the Committee report, both of which are reprinted above, we disagree with the position reached by this commentary. If this commentary is correct, this would mean many small banks that are currently exempt from filing on magnetic media because they file less than 250 of each type of information return would now have to start filing on magnetic media. (For example, under the present law, ABC Bank is exempt from filing on magnetic media if it files 230 5498s and 30 1099-Rs, because it files less than 250 of each type of form.) However, we don't believe that this was the intent of the drafters or that this is what the law says. We will monitor this situation and let you know of further developments in this area in The Pension Digest.

Summary

OBRA contains many provisions modifying penalties for incomplete or incorrect information returns. This article summarized Act provisions relating to IRA reporting. The Act also includes expanded penalties for fraud, for underpayment of taxes, a twenty percent penalty for underpayment of taxes due to negligence, and numerous other penalties. Congress seems to be serious about enforcing compliance with the tax laws, and is using these increased penalties to encourage compliance. PD



ACT NOW IF YOU ARE CONSIDERING A WAIVER FROM MAGNETIC MEDIA FILING DUE TO REV. PROC. 89-52

The now infamous Rev. Proc. 89-52, which requires IRA custodians to generate multiple Form 5498s in the year an accountholder dies, is still causing problems for many IRA custodians. Understanding the rules is generally not the problem. In many cases, the compliance problem is getting a data system to properly generate the multiple Form 5498s.

Because of programming and data system problems, some IRA custodians may be considering filing for a hardship waiver from the magnetic media requirements. Be aware that waiver requests must be filed at least ninety days before the due date of the 5498 return. Since the due date of Form 5498 is May 31, 1990, if you are going to file for a hardship waiver and comply with the ninety days in advance rule, file for your waiver by February 28, 1990.

If you know now that you are going to file for a waiver, we suggest you file early and make certain that you will be granted a waiver. Use IRS Form 8508, available from the IRS Computing Center in Martinsburg, West Virginia, to request your hardship waiver. PD

ITS OFFICIAL: THE OMNIBUS BUDGET RECONCILIATION ACT OF 1989 IS NOW LAW

On December 19, 1989, President Bush signed into law H.R. 3299, the so-called Omnibus Budget Reconciliation Act of 1989. The lengthy Act contains changes repealing Section 89, modifying the ESOP rules, accelerating payments of income tax that has been withheld, and modifying penalties for improper tax filings.

The Act contains changes affecting a broad cross section of tax law. This article summarizes the Act changes affecting employee benefits.

Section 89 Has Been Repealed

Easily one of the least popular laws enacted in recent years, Section 89 mandated tough nondiscrimination and qualification rules affecting a broad array of employee benefits, including employer-provided health insurance and life insurance. (Section 89 did not affect qualified retirement plans.)

With the elimination of these complex, unpopular rules, the prior law non-discrimination rules generally apply, affecting group term life insurance plans dependent care assistance plans, cafeteria plans, and employer provided self-insured medical reimbursement plans.

Employee Stock Ownership Plans (ESOPs)

Some of the benefits of ESOPs have been reduced by the Act. The Act limits the availability of the fifty percent interest income exclusion to lenders to situations where the ESOP owns more than fifty percent of the stock of the corporation. The Act contains numerous other changes affecting ESOPs. If you work with ESOPs, you should review the Act.

FICA And Income Tax Withholding Changes

The Act accelerates the deadline for paying in withheld FICA and income tax when an employer has $100,000 or more

Continued on Page 6

QUALIFIED PLANS
MURPHY V. DAWSON: LIABILITY OF INVESTMENT ADVISOR WHO IS MAKING SPECIFIC RECOMMENDATIONS FOR A QUALIFIED PLAN

With qualified plans, there has been an increasing amount of litigation on the liability of investment advisors to a qualified plan. Every qualified plan must have a named fiduciary who is responsible for the operation of the plan, including the investments of the plan. The plan may name this fiduciary or describe how this fiduciary is selected. Sometimes an outside party like a broker or financial planner shares this fiduciary responsibility with an officer of the employer or trustee of the plan. Typically, this means that the broker or planner makes recommendations specifically designed for the plan, which the officer or trustee or other plan designee, who is also a fiduciary, must review and approve.

This article reviews the recent California case of Murphy v. Dawson, (1989 CA 4) where an outside investment advisor shared the fiduciary duties regarding investments with the plan trustee. The outside advisor was held liable for violating his fiduciary duties to the plan for his poor investment recommendations, even though the plan trustee, the dentist who owned the business, had the authority and responsibility to review his investment recommendations.

The Facts

The plaintiff, Murphy, a dentist, named the defendant, Dawson, as the investment advisor for the plan. As investments, Dawson recommended two real estate loans that offered a high return, but were high risk loans secured by second mortgages. Dawson recommended these loans without securing an independent appraisal of the real estate and without investigating the credit rating of the borrower.

Dawson was found guilty of violating the prudent man rule, which states that a fiduciary must act with the care, skill, prudence, and diligence that a prudent man, acting in a like capacity and familiar with such matters would use in conducting an enterprise of a like character and with like aims.

In his defense, Dawson argued that since Murphy was a co-fiduciary and had to approve any investments, Murphy should be held responsible. Dawson was attempting to have Murphy found either solely responsible or jointly responsible as a co-fiduciary.

The U.S. Fourth Circuit Court of Appeals rejected Dawson's defense. The court found that Dawson had the specific responsibility to make investment recommendations and that he had violated his responsibilities in this role. PD to pay in at the end of any eighth-monthly withholding period. The following chart shows how the deadline for making these deposits varies in different calendar years.

In The Case Of:	*The Applicable Banking Day Is:*
1990	1st
1991	2nd
1992	3rd
1993	4th
1994	1st

Penalty Provisions

A separate act, "The Improved Penalty and Compliance Act" was included within the Omnibus Budget Reconciliation Act. As a result of this new Act, substantially larger penalties can be imposed, some penalties have been consolidated, and some changes have been made in the magnetic media reporting rules.

These changes are explained in the separate article in this issue of The Pension Digest, entitled "New Act Means Larger Penalties For Non-compliance With IRA Reporting." PD

USER UPDATE: CWF PROTOTYPE QUALIFIED PLANS HAVE BEEN APPROVED

On January 4, 1990, the IRS issued favorable opinion letters with respect to the eight prototypes of Collin W. Fritz and Associates, Ltd. The IRS has also issued letters to other mass submitters.

The issuance of these letters means the conversion process may finally start. The conversion process requires the completion of new adoption agreements, new SPD's, etc. We realize this is not everyone's favorite subject. Next month's newletter will discuss this amendment/conversion topic in substantial detail.

Collin W. Fritz & Associates, Ltd. or your mass submitter will be submitting the prototypes your bank has chosen to the IRS for your own individual favorable opinion letters. The filing for the bank must be made on or before March 31, 1990. If so made, then the customers of your bank will have as their deadline to sign the new and revised prototypes—the end of the twelth month after the IRS issues your bank its favorable opinion letter. It is probably best to start this conversion process as early as possible. PD

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Question: We have an employer that has a small business, operates on a calendar year, and wants to establish and fund a qualified plan now for 1989. Can he establish a qualified plan for 1989?

✔ No, he cannot. Qualified plans must be established in writing by the end of the employer's tax year. Since the employer has a calendar year tax year and has not yet established his plan, it is too late now to establish and fund a qualified plan for 1989. However, the employer has until his tax return due date to establish a Simplified Employee Pension (SEP) and make 1989 contributions.

Question: We have a customer that is not yet age 59-1/2 who wants to withdraw funds from her IRA using the 10% penalty exception for a series of substantially equal periodic payments. She only wants to withdraw funds from her IRA with us and wants to leave her other IRA alone. Is she required to aggregate both IRAs in order to take advantage of the exception to the 10% penalty?

✔ No, aggregation of her two IRAs is not required. Internal Revenue code section 72(t)(2)(A)(IV) which offers this exception does not require aggregation. This answer is also confirmed by a recent IRS ruling, Letter Ruling 8946045.

Question: In calculating substantially equal periodic payments for this 10% penalty exception, we plan to amortize the accountholder's account balance over the accountholder's life expectancy using a "reasonable" assumed interest rate. What is considered a "reasonable" assumed interest rate?

✔ Because this is a relatively new, not widely used exception, there is not a lot of guidance on this. However, Private Letter Ruling 8946045 offers guidance. The ruling permitted using an assumed interest rate equal to 120% of the long term applicable federal rate determined on an annual payment basis and rounded off to the nearest two-tenths of one percent for August, 1989.

Here is part of Private Letter Ruling 8946045, explaining how this "reasonable interest rate" was determined.

> Q&A-12 of Notice 89-25, 1989-12 I.R.B. 68, provides several methods for complying with the Code section 72(t)(2)(A)(iv) exception. Under one of these methods, payments will be treated as substantially equal periodic payments within the meaning of section 72(a)(2)(A)(iv) if the annual amount to be distributed is determined by amortizing the taxpayer's account balance over a number of years equal to the life expectancy of the account owner or the joint life and last survivor expectancy of the account owner and beneficiary (with life expectancy determined in accordance with proposed section 1.401(a)(9)-1 of the Regulations) at an interest rate that does not exceed a reasonable interest rate on the date distributions commence.
>
> Section 7520(a) of the Code directs the Secretary of the Treasury to prescribe tables for purposes of determining the value of any annuity, any interest for life or a term of years, or any remainder or reversionary interest, as may be necessary under the Code. Section 7520(a)(2) directs that the interest rate to be used in such tables is equal to 120 percent of the Federal midterm rate (rounded to the nearest 2/10ths of 1 percent) for the month in which the valuation date falls.
>
> In this case, for purposes of determining and making annual distributions from an IRA, the application of the life expectancies of Table V of section 1.72-0, using your attained age as of your birthday in the calendar year in which distributions commence with an interest rate equal to 120 percent of the long-term applicable federal rate for August 1989 determined on an annual payment basis and rounded off to the nearest two-tenths of one percent will result in distributions which are part of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of such employee and his designated beneficiary. PD

The Pension Digest invites your questions and comments.
Please address to "Check It Out," Collin W. Fritz & Associates, Ltd., P.O. Box 426, Brainerd, MN 56401.

THE Pension Digest EXTRA

A supplement to your monthly pension newsletter.

QUALIFIED PLANS
IRS ANNOUNCES EXTENSION OF REMEDIAL AMENDMENT PERIOD FOR CERTAIN QUALIFIED PLANS

In mid-December, the IRS Released Revenue Procedure 89-65, which contains many housekeeping announcements regarding Qualified Plans, including extending the remedial amendment period for certain plans. As part of this Revenue Procedure, the IRS announced that it will begin accepting applications for determination letters in early January of 1990.

This article summarizes the main provisions of Revenue Procedure 89-65. If you would like a copy of this complete revenue procedure, send a stamped, self-addressed envelope to The Pension Digest, c/o Collin W. Fritz and Associates, Ltd., P.O. Box 426, Brainerd, MN 56401.

What This Ruling Says:

Remedial amendments are amendments that can be used to bring an existing plan or newly adopted plan into compliance with certain law changes. This ruling states that remedial plan amendments under Code section 401(b) that were required to be made by the Tax Reform Act of 1986 do not have to be made until the end of the first plan year beginning after December 31, 1990. For example: for a calendar year plan, the deadline would be December 31, 1991.

This extension gives sponsors of qualified pension, profit-sharing and stock bonus plans under section 401(a) of the Code and annuity plans under section 403 (a) of the Code additional time to review proposed regulations and make decisions as to how to redesign their plans to comply with the Tax Reform requirements. Thus, plans that do not satisfy the requirements of section 401(a) or 403(a) because of a disqualifying provision described in section 1.401(b)-1(b)(2)(ii) may be retroactively amended to meet such requirements at any time up to and including the last day of the 1991 plan year.

In addition, this revenue procedure provides that the definition of disqualifying provision under section 1.401(b)-1(b)(2)(ii) includes a plan provision (or the absence of a plan provision) that causes a plan to fail to satisfy the qualification requirements of the Code because of changes made in such requirements by TAMRA or a plan provision that is not required, but is integral to a qualification requirement changed by TAMRA. Thus, plans that do not satisfy the requirements of section 401(a) or 403(a) because of such a disqualifying provision may also be retroactively amended to meet such requirements at any time up to and including the last day of the 1991 year.

This revenue procedure also extends the remedial amendment period for new plans adopted after December 31,1987, that do not satisfy the qualification requirements of sections 401(a) or 403(a) as of the date such plan is put into effect, and for existing plans that are amended after December 31, 1987, which therefore fail to satisfy the qualification requirements of sections 401(a) or 403(a) as of the date such amendment is adopted or effective (whichever is earlier). The remedial amendment period as extended will expire on the last day of the first plan year beginning after December 31, 1990. Thus, these otherwise non-complying plans may be amended to comply retroactively with such requirements at any time up to and including the last day of the 1991 plan year.

To be eligible for this extended remedial amendment period, a plan must continue to meet the requirements of section 1140 of TRA '86. Thus, with respect to requirements subject to section 1140 (i.e., TRA '86 requirements that are effective for plan years beginning before January 1, 1989), the plan sponsor must operate the plan in accordance with such requirements from the applicable effective dates with respect to the plan.

In addition to these extensions, certain collectively bargained plans that were not eligible for the remedial amendment period are not eligible. Model Amendment Three can continue to be used, under Notice 88-131, by plan sponsors to continue to suspend benefit accounts beyond the 1989 plan year.

Guidance on the 50/40 Regulations

(1) The proposed regulations under section 401(a)(26) provide, in general, that for purposes of determining whether a plan benefits at least 50 employees or 40% of all employees, each separate benefit structure must be tested separately. Section 1.401(a)(26)-2(d) of the proposed regulations provides that a separate current benefit structure will exist for purposes of section 401(a)(26) with respect to each portion of a uniform benefit formula to the extent that subsidies, optional forms of benefits, rights or features are not provided in a uniform manner to all employees eligible to participate under such formula. Section 1.401(a)(26)-8(b)(1) provides a simplified method for identifying current benefit structures under section 401(a)(26) which is available during the 1989 plan year. Under section 1.401(a)(26)-8(b)(1), the only rights and features to be taken into account are the bases and conditions applicable to the

determination of an employee's contribution allocation under a defined contribution plan and the bases and conditions applicable to an employee's normal retirement benefit, early retirement benefit (to the extent such benefit is reduced by less than 3% for each year of early commencement), or joint and survivor annuity benefit, and any accrual, availability, and eligibility conditions related to these normal retirement, early retirement, or joint and survivor annuity benefits.

(2) This revenue procedure provides that for plan years beginning before the later of January 1, 1992 or the date that is 60 days following the publication of final regulations, a plan is only required to meet the transitional rule of section 1.401(a)(26)-8(b)(1) of the proposed regulations with regard to current benefit structures.

Guidance on 401(k) Deferral Limits

Section 401(k) salary deferral plans contain limits on deferrals for eligible highly compensated employees under 401(k)(3) called the ADP test and limits on contributions under 401(m)(2) called the ACP test. For both the ADP and ACP tests, an alternate limit which can be used is "the lesser of 200% of, or 2 percentage points more than, the applicable percentage for eligible non-highly compensated employees." Regulations prohibiting simultaneously using the alternate test for both the ADP & ACP tests were generally effective beginning with the 1989 plan year. The Revenue Procedure 89-65 calls this simultaneous use "multiple use." According to the Rev. Proc.,

> "Multiple use occurs only if a highly compensated employee is eligible under both a cash or deferred arrangement subject to section 401(k) and a plan subject to section 401(m), and only if the sum of the ADP for the highly compensated employees in the section 401(k) plan and the ACP for the Highly compensated employees in the section 401(m) Plan exceeds the aggregate limit. The aggregate limit is described in section 1.402(m)-2(b)(3)(i) and is calculated by adding two percentages determined by reference to the ADP and ACP for the non-highly compensated employees in these plans.
>
> (2) This revenue procedure provides that for plan years beginning before the later of January 1, 1992 or the date that is 60 days after publication of final regulations, the aggregate limit is increased to the greater of the aggregate limit in section 1.402(m)-2(b)(3)(i) or the following new aggregate limit. The new aggregate limit is the sum of :
>
> (A) 125 percent of the lesser of (1) the actual deferral percentage of the group of non-highly compensated employees eligible under the arrangement subject to section 401(k) for the plan year, or (2) the actual contribution percentage of the group of non-highly compensated employees eligible under the plan subject to section 401(m) for the plan year beginning with or within the plan year of the arrangement subject to section 401(k), and
>
> (B) Two plus the greater of (1) or (2) above. In no event, however, shall this amount exceed 200 percent of the greater of (1) or (2) above."

Definition of "Compensation" That Must be Taken Into Account

Section 1.401(k)-1(g)(9)(ii) provides that, for plan years beginning after December 31, 1988, or on or after the later date provided in section 1.401(k)-1(h), a plan must take into account all compensation received by a participant for the plan year in which the plan is being tested for compliance with the nondiscrimination tests of section 401(k)(3). Section 1.401(k)-1(g)(9)(ii) of the proposed regulations clarifies that, in the case of an employee who begins, resumes, or ceases to be eligible to make elective contributions during a plan year, all compensation received by the employee during the entire plan year must be taken into account. In addition, for the first plan year of the cash or deferred arrangement, the compensation to be taken into account in computing the actual deferral ratio of an employee includes compensation received by the employee during the 12-month period ending on the last day of such plan year. Similar rules are contained in section 1.401(m)-1(f)(14) of the proposed regulations. Section VI of Notice 88-127 provides that final regulations will be amended to provide that, for plan years beginning before January 1, 1990, or before the later date provided in section 1.401(k)-1(h), if applicable, a plan may limit, if it chooses, the compensation taken into account to compensation received by an employee while the employee is a plan participant.

This revenue procedure modifies section VI of Notice 88-127 to provide that, for plan years beginning before the later of January 1, 1992 or the date that is 60 days after publication of final regulations, a plan may limit the compensation taken into account to compensation received by an employee while the employee is a plan participant.

The 414(S) Definition of Compensation

Section 1.414(s)-1T, Q&A-1(a), of the temporary regulations provides the basic definition of compensation generally applicable to nondiscrimination rules under section 401 through 419A of the Code. Section 1.414(s)-1T, Q&A-4(a), provides that employers may elect, for applicable periods beginning in 1987 and 1988, to use specified alternative definitions of compensation provided certain conditions are met.

Pursuant to this revenue procedure, an employer may, for applicable periods beginning before the later of January 1, 1992 or the date that is 60 days after the publication of final regulations, use the alternative definitions of compensation provided for in section 1.414(s)-1T, Q&A-4(a), provided the conditions set forth for using those alternatives are met.

You Can Call the Author of this Ruling

The principal author of this revenue ruling is Charles D. Lockwood of the Employee Plans Technical and Actuarial Division. For further information regarding this revenue ruling, contact the Employee Plans Technical and Actuarial Division's taxpayer assistance telephone service or Mr. Lockwood between the hours of 1:30 p.m. and 4 p.m. Eastern Time, Monday through Thursday by calling (202) 566-6783/6784 or (202) 343-0729, respectively. (These telephone numbers are not toll-free numbers.) PD