THE Pension Digest

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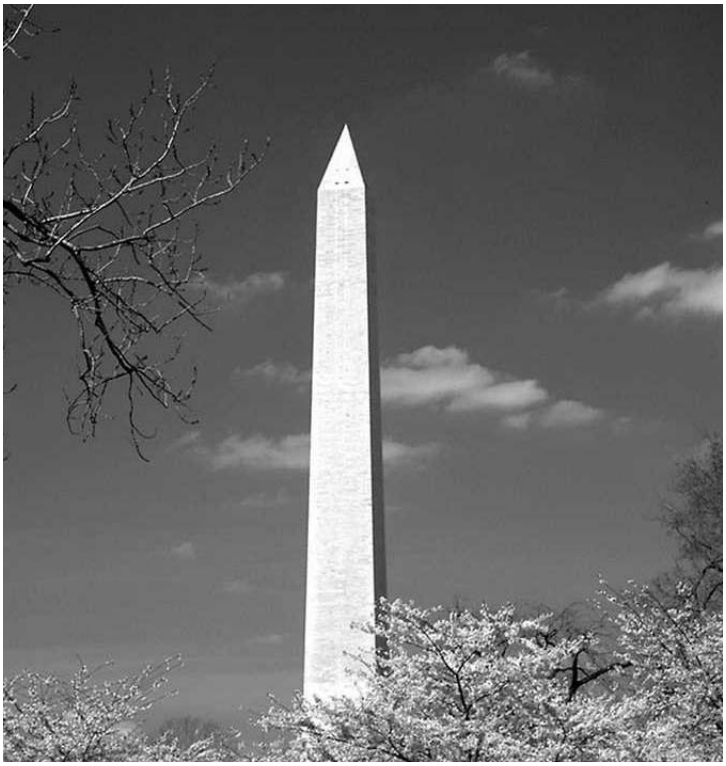
## ALSO IN THIS ISSUE –



## TAX BILL VETOED

President Clinton vetoed the tax bill which had been presented to him. The veto was certainly expected. Most likely there will not be a tax bill in 1999. Certainly any tax bill will not be of the magnitude of the vetoed bill. As was mentioned in the August newsletter, many of the proposed changes were not effective until year 2001 or later. ◆



## 1999 IRS PUBLICATION 1179—

### ADDITIONAL DISCUSSION OF SUBSTITUTE IRA FORMS

The IRS has recently issued Revenue Procedure 99-34. It will be reproduced as the October 1999 revision of Publication 1179. The 1998 version is now superseded. Revenue Procedure 99-34 provides the 1999 requirements for:

1. Using official Internal Revenue Service (IRS) forms to file certain information returns with the IRS.

2. Preparing acceptable substitutes of the official IRS forms to file information returns with the IRS, and

3. Using official or acceptable substitute forms to furnish information to a recipient.

The July newsletter discussed the subject of the use of substitute IRA statements. This article updates that prior article which was limited to the subject of a substitute statement for the Form 5498, but not for the Form 1099-R.

The information returns covered by Revenue Procedure 99-34 are 1096, 1098, 1098-E, 1098-T, 1099-A, 1099-B, 1099-C, 1099-DIV, 1099-G, 1099-INT, 1099-LTC, 1099-MISC, 1099-MSA, 1099-OID, 1099-PATR, 1099-R, 1099-S, 5498, 5498-MSA and W-2G.

As mentioned in the July newsletter, the rules differ depending upon the form being filed or furnished. This article discusses the rules for the IRA forms. You will need to refer to the Revenue Procedure for the rules for the nonIRA forms.

Section 1.5.4 sets forth the following rules for—Substitute Statements for Recipients—for Certain Forms 1098, 1099, 5498 and W-2G as follows:

Statements to form recipients for Forms 1098, 1098-E, 1098-T, 1099-A, 1099-B, 1099-C, 1099-G, 1099-LTC, 1099-MISC, 1099-MSA, 1099-R, 1099-S, 5498, 5498-MSA, W-2G, 1099-DIV (only for section 404(k) dividends reportable under section 6047),

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and 1099-INT (only for interest on $600 or more made in the course of a trade or business reportable under section 6041) can be copies of the official forms or an acceptable substitute. To be acceptable, a substitute form recipient statement must meet the following requirements.

1. The tax year, form number, and form name must be the same as the official form and must be displayed prominently together in one area on the statement. For example, they may be shown in the upper right part of the statement.
2. The filer's and the form recipient's identifying information required on the official IRS form must be included.
3. Each substitute recipient statement for Forms W-2G, 1098, 1098-E, 1098-T, 1099-A, 1099-B, 1099-DIV, 1099-G (excluding state and local income tax refunds), 1099-INT, 1099-LTC, 1099-MISC (excluding fishing boat proceeds), 1099-OID, 1099-PATR, and 1099-S must include the direct access telephone number of an individual who can answer questions about the statement. You may include the telephone number conspicuously anywhere on the recipient statement. Although not required, payers reporting on Forms 1099-C, 1099-MSA, 1099-R, 5498 and 5498-MSA are encouraged to furnish telephone numbers.
4. All applicable money amounts and information, including box numbers, required to be reported to the form recipient must be titled on the form recipient statement in substantially the same manner as those on the official IRS form. The box caption **"Federal income tax withheld"** must be in boldface type on the form recipient statement.

   **Exception.** If you are reporting a payment as "Other income" in box 3 of Form 1099-MISC, you may substitute appropriate language for the box title. For example, for payments of accrued wages and leave to a beneficiary of a deceased employee, you might change the title of box 3 to "Beneficiary payments" or some-

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## Table – Additional Instructions Concerning Copies B, C, D, 1 and 2 of Substitute IRA Forms

| Item | Instructions |
|---|---|
| Copies | Copies B, C, and in some cases, D, 1, and 2 are included in the official assembly for the convenience of the filer. You are not required to include all these copies with the privately printed substitute forms. Copies B and, in some cases, C will satisfy the requirement of the law and regulations to provide the statement of information to the form recipient.<br><br>Note: If an amount of Federal income tax withheld is shown on Form 1099-R or W-2G, Copy B (to be attached to the tax return) and Copy C must be furnished to the recipient. *Copy D (Forms 1099-R and W-2G) may be used for filer records. Only Copy 1 should be filed with the IRS.* (Emphasis added.) |
| Arrangement of Assembly | The parts of the assembly must be arranged, from top to bottom, as follows:<br>+ All forms—Copy A "For Internal Revenue Service Center."<br>+ Form 1099-R—Copy 1 "For State, City, or Local Tax Department";<br>Copy B "Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 4, attached this copy to your return:"<br>Copy C "For Recipient's Records";<br>Copy 2 "File this copy with your state, city, or local income tax return, when required";<br>Copy D "For Payer."<br>+ Form 5498—Copy B "For Participant";<br>Copy C "For Trustee or Issuer."<br>+ Form 5498-MSA—Copy B "For Participant";<br>Copy C "For Trustee." |
| Perforations | Perforations are required between forms on all copies except Copy A to make separating the forms easier. Copy A of Form W-2G may be perforated. |
| OMB Requirements | The OMB requirements for substitute IRS forms are:<br>+ Any substitute form or substitute statement to recipient must show the OMB number as it appears on the official IRS form.<br>+ For Copy A, the OMB number must appear exactly as shown on the official IRS form.<br>+ For any copy other than Copy A, the OMB number must use one of the following formats.<br>1. OMB No. XXXX.XXXX (preferred) or<br>2. OMB #XXXX.XXXX<br>+ All substitute forms (Copy A only) must state "For Privacy Act and Paperwork Reduction Act Notice, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G." |

In addition, the substitute statement (or the instructions) must state:

1. Why the IRS is collecting the information.
2. How it will be used, and
3. Whether it must be given to the IRS.

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thing similar.

**Note:** *You cannot make this change on Copy A.*

5. You must provide appropriate instructions to the form recipient, similar to those on the official IRS form, to aid in the proper reporting on the form recipient's income tax return. For payments reported on Form 1099-B, the requirement to include instructions substantially similar to those on the official IRS form may be satisfied by providing form recipients with a single set of instructions for all Forms 1099-B statements required to be furnished in a calendar year.

   **Note:** *If Federal income tax is withheld and shown on Form 1099-R or W-2G, Copy B and Copy C must be furnished to the recipient. If Federal income tax is not withheld, only Copy C of Form 1099-R or W-2G must be furnished. However, for Form 1099-R, instructions similar to those on the back of the official Copy B and Copy C of Form 1099-R must be furnished to the recipient. For convenience, you may choose to provide both Copies B and C of Form 1099-R to the recipient.*

6. If you use carbon to produce recipient statements, the quality of the carbon must meet the following standards:
   - All copies must be **clearly legible,**
   - All copies must be able to be photocopied, and
   - Fading must not diminish legibility and the ability to photocopy.

   In general, black chemical transfer inks are preferred, but other colors are permitted if the above standards are met. Hot wax and cold carbon spots are not permitted on any of the internal form plies. The back of a mailer top envelope ply may contain these spots.

7. A mutual fund family may state separately on one document (e.g., one piece of paper) the Form 1099-B information for a recipient from each fund as required by Form 1099-B. However, the gross proceeds, etc., from each transaction within a fund must be stated separately. The form must contain an instruction to the recipient that each fund's (not the mutual fund family's) name and amount must be reported on the recipient's tax return. The form cannot contain an aggregate total of all funds.

8. You may use a Uniform Settlement Statement (under the Real Estate Settlement Procedures Act of 1974 (RESPA)) for Form 1099-S. The Uniform Settlement Statement is acceptable as the written statement to the transferor if you include the legend for Form 1099-S below and indicate which information on the Uniform Settlement Statement is being reported to the IRS on Form 1099-S.

9. For reporting state income tax withholding and state payments, you may add an additional box(es) to recipient copies as appropriate.

   **Note:** *You cannot make this change on Copy A.*

10. On Copy C of Form 1099-LTC, you may reverse the location of the policyholder's and the insured's name, street address, city, state, and ZIP code for easier mailing.

11. Logos are permitted on substitute recipient statements for the forms listed in this section (**Section 1.5.4**).

Section 1.5.5 sets forth the legend requirements for the Form 1099-MSA and the Form 1099-R as follows:

- **Form 1099-MSA**—"This information is being furnished to the Internal Revenue Service"
- **Form 1099-R**

  **Copy B**—"Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 4, attached this copy to your return. This information is being furnished to the Internal Revenue Service."

  **Copy C**—"This information is being furnished to the Internal Revenue Service."

Section 1.5.7 sets forth the legend requirements for the Form 5498-MSA and the Form 5498 as follows:

- **Form 5498**—"This information is being furnished to the Internal Revenue Service."

  **Note:** *If you do not furnish another statement to the participant because no contributions were made for the year, the statement of the fair market value of the account must contain this legend and a designation of which information is being furnished to the Internal Revenue Service.*
- **Form 5498-MSA**—"The information in boxes 1 through 6 is being furnished to the Internal Revenue Service."

Section 1.5.8 sets forth the rules for composite substitute statements for recipients for forms specified in section 1.5.4 as follows:

A composite form recipient statement for the forms specified in **Section 1.5.4** is permitted when one filer is reporting more than one type of payment during a calendar year to the same form recipient. A composite statement is not allowed for a combination of forms listed in **Section 1.5.4** and forms listed in **Section 1.5.2.**

**Exceptions.** Form 1099-B information may be reported on a composite form with the forms specified in **Section 1.5.2** as described in **Section 1.5.3**. In addition, royalties reported on Form 1099-MISC or 1099-S may be reported on a composite form only with the forms specified in **Section 1.5.2.**

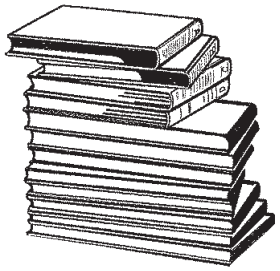
Although the composite form recipient statement may be on one sheet, the format of the composite form recipient statement must satisfy the requirements listed in **Section 1.5.3** as well as the requirements in **Section 1.5.4.** A composite statement of Forms 1098 and 1099-INT (for interest reportable under section 6049) is **not** allowed.

The second and third parts of the revenue procedure 99-34 set forth the specifications for substitute forms to be filed with the IRS. This topic is not discussed in this article because most IRA custodians/trustees will file this information via magnetic media or by e-mail. You should refer to this section of the Revenue Procedure if you wish to file a substitute form with the IRS.

### OMB and Other Additional Rules

The fourth part of Revenue Procedure 99-34 sets forth the following additional instructions for substitute forms. What copies must be furnished? Is there a required order to the assembly of the substitute forms? Must the substituted statement forms be perforated? What requirements does the OMB have? Special attention should be paid to the OMB requirements.

The table on page 2 gives the additional instructions concerning copies B, C, D, 1, and 2 of the forms. ◆



# STILL NO FORMAL IRS GUIDANCE ON QP PROTOTYPES

The IRS has still not issued any formal guidance on when QP prototypes must be amended and when it will be permissible to submit the updated prototypes. The IRS has not yet finalized the revenue procedure of their suggested language to use in certain situations (i.e. language required modifications). Presumably, the uncertainly about the tax bill caused some delay in existing IRS projects. We believe it could be another 2-3 months before the IRS issues formal guidance. ◆

# SEP AND QP PLANS AND ELIMINATION OF CODE SECTION 415(e)—WHAT CHANGES TO COME?

The Small Business Job Protection Act of 1996 repealed the rules of Code section 415(e) for limitations years beginning after December 31, 1999. In general, this means an employer, as of January 1, 2000, is no longer required to maintain a limitation on contributions and benefits. Note the January 1, 2000, date is correct only if the plan has a calendar year limitation year.

The repeal of Code section 415(e) was a major law and policy change. The purpose of this article is to set forth some of the changes we foresee as a consequence of this change.

Historical Background. Congress and the IRS have always worried that some businesses might misuse the pension plan rules by making too large a contribution for a given employee/plan participant. The Code contains three limits which must be considered by an employer before making its contribution for a given year. The limits are: (1) the contribution and benefit limits of Code section 415; (2) the compensation limits of code section 417; and (3) the deduction limits of Code section 404.

Code section 415 contains three types of limits. The first type is for defined contribution plans (e.g. profit sharing plans, money purchase plans, 401(k) plans) and for SEP and 403(b) plans which are treated as defined contribution plans. The annual contribution limit is the lesser of $30,000 or 25% of the participant's compensation. This limit applies on an aggregate basis if the employee is a participant in more than one plan as sponsored by the same employer. The second type of section 415 limit is for defined benefit plans. In general, the annual benefit paid to a participant of a defined benefit plan cannot be greater than the lesser of: (A) $90,000 or (B) 100% of the participant's average compensation for his or her high three years.

The third type of limit is when an employee is a participant in both a defined contribution plan and a defined benefit plan. This is the limit imposed by Code section 415(e). In general, when an individual is a participant in both a defined benefit plan and a defined contribution plan maintained by the same employer, the sum of the defined benefit plan fraction and the defined benefit fraction for any year may not exceed 1.0. The defined benefit fraction for any year is a fraction, the numerator of which is the projected annual benefit determined as of the close of the year, and the denominator of which is the lesser of: (1) 1.25 times $90,000 or (2) 1.4 times 100% of the participant's average compensation of his or her high three years. The defined contribution plan fraction for any year is a fraction, the numerator of which is the sum of the annual additions to the participant's account since the plan's inception as of the close of the year, and the denominator of which is the sum of the lesser of the following amounts determined for the current year and for each prior year of service with the employer: (1) 1.25 times $30,000 or (2) 1.4 times 25% of his or her compensation.

The concept was—an employee was not able to receive both the full defined benefit limit and the defined contribution limit. These two limits had to be coordinated. So, plans had to be written to provide for this coordination. The coordination language was quite extensive in qualified plans.

Code section 417 imposes the rule that the plan may not use more than $150,000 (as indexed) for plan contribution and benefit purposes. The current limit is $160,000. At one time there was no limit. The limit then changed to $200,000, then to $150,000 and now to $160,000.

Code section 404 limits the amount of the tax deduction which an employer is allowed with respect to its annual contribution. In general, the tax deduction limit with respect to a defined benefit plan for an employer is the amount necessary to satisfy the minimum funding rules. The tax deduction limit for a profit sharing plan is 15% of compensation. The tax deduction limit for a money purchase plan is 25% of compensation.

To illustration the basic concepts of these limits, we will consider the situation of Serena Dillon, a professional tennis player. It is assumed she has gross income of $6,500,000, and she will have net income of $6,000,000. She has only one assistant whom she pays $50,000.

But for the above limits, she might choose to contribute a very large amount (e.g. $5,900,000) to a profit sharing plan so she would pay minimal federal income tax. The public policy is not to allow such large contribution amounts to be deductible. Also, but for the above limits, she could set the contribution percentage at .005 so she would receive a contribution of $30,000 ($600,000 x .005) and the other employee would receive only $250.00 ($50,000 x .005). The public policy is to not allow her to do this. Under the existing law, Serena may have contributed for her the amount of $24,000 and the other employee will receive a contribution of $7,500. Clearly the purpose of these limits is to reduce the amount which can be contributed for highly-compensated individuals and increase the contribution amount for nonhighly-compensated participants.

Well, one of the main rules which had the effect of reducing the contribution and/or benefit limit for higher compensated individuals has been repealed. An employee who participates in both a defined contribution plan and a defined benefit plan will be entitled to maximize his or her contributions and benefits under both types of plans after December 31, 1999.

### What Changes?

What changes will come because of the repeal of Code section 415(e)?

1. The IRS will rewrite its Model SEP forms (e.g. Form 5305-SEP). The current version contains the statement that an employer cannot use the Form 5305-SEP if it currently or if it ever sponsored a defined benefit plan. This statement should be deleted.

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**Elimination of 415(e), Continued from page 4**

2. The IRS will change the mandatory provisions for SEP prototypes. Presently SEP prototypes contain the statement that an employer cannot adopt the prototype if it has ever sponsored a defined benefit plan. This means the SEP prototype document must then be considered to be an individually designed SEP plan. The IRS filing fee for individually designed SEP plans is very expensive—in the range of $2,300. Employers who had sponsored a defined benefit plan now will be able to adopt a SEP prototype and have reliance (i.e. they will not have to treat their prototype document as an individually designed document).

CWF is going to wait until January of 2000 before filing a revised and updated SEP prototype with the IRS. By waiting until January, the document will not have to contain the rules which apply for 1999 but not for 2000.

The conclusion: more businesses will want SEP plans in year 2000 and subsequent years.

3. More businesses (even one-person businesses such as farmers) will establish defined benefit plans because they can now have both defined contribution and defined benefit plans. They will be able to deduct their permissible contributions to both types of plans. CWF will most likely be writing such defined benefit prototypes.

4. Qualified Plan documents will also need to be revised for the repeal of Code section 415(e). Pursuant to Revenue Procedure 99-23, the remedial amendment period for plan amendments relating to recent legislation (including the repeal of section 415(e) for most plans has been extended to the last day of the first plan year beginning on or after January 1, 2000.

The IRS has recently issued Notice 99-44 on August 30, 1999, to give guidance on this issue before prototypes and other QP documents are amended. Although quite lengthy, set forth below are the Questions and Answers from this Notice.

Q-1: What is the effective date of the repeal of § 415(e) of the code by § 1452(a) of SBJPA?

A-1: In accordance with § 1452(d)(1) of SBJPA, § 415(e) of the Code is repealed effective as of the first day of the first limitation year beginning on or after January 1, 2000. With respect to limitation years beginning on or after January 1, 2000, a defined contribution plan will not fail to satisfy § 415 solely because the annual additions for any participant for such years exceed the pre-SBJPA § 415(e) limitations. With respect to limitation years beginning on or after January 1, 2000, a defined benefit plan will not fail to satisfy § 415 solely because the plan provides that the benefit of any participant exceeds the pre-SBJPA § 415(e) limitations. Accordingly, the pre-SBJPA § 415(e) limitations will not limit the benefit of a participant in a defined plan whose benefit has not commenced as of the first day of the first limitation year beginning on or after January 1, 2000. For rules regarding the application of the Pre-SBJPA § 415(e) limitations to a participant in a defined benefit plan whose benefit has commenced as of that date, see Q&A-3 and 4.

Q-2: If a plan is not amended to take into account the repeal of § 415(e), how may the benefits of plan participants be affected?

A-2: If a plan is not amended to take into account the repeal of § 415(e), the effect on the benefits of plan participants will depend on the plan's existing provisions for applying the limitations of § 415(e) and any other relevant plan provisions. In some circumstances, a plan's existing provisions could result in automatic benefit increases for participants as of the effective date of the repeal of § 415(e) for the plan. For example, the repeal of § 415(e) could result in automatic benefit increases for participants in defined benefit plans that incorporate by reference the limitations under § 415(e). Similarly, the repeal of § 415(e) could result in automatic changes to annual additions for participants in defined contribution plans.

Q-3: May a defined benefit plan provide for benefit increases to reflect the repeal of § 415(e) for a current or former employee who has commenced benefits under the plan prior to the effective date of the repeal?

A-3: A defined benefit plan may provide for benefit increases to reflect the repeal of § 415(e) for a current or former employee who has commenced benefits under the plan prior to the effective date of the repeal of § 415(e) for the plan, but only if the employee or former employee is a participant in the plan on or after that effective date. For this purpose, an employee or former employee is a participant in the plan on a date if the employee or former employee has an accrued benefit (other than an accrued benefit resulting from a benefit increase that arises solely as a result of the repeal of § 415(e)) on that date. Thus benefit increases to reflect the repeal of § 415(e) cannot be provided to current or former employees who do not have accrued benefits under the plan on or after the effective date of the repeal of § 415(e) for the plan. However, if a current or former employee accrues additional benefits under the plan that could have been accrued without regard to the repeal of § 415(e) (including benefits that accrue as a result of a plan amendment) on or after the effective date of the repeal of § 415(e) for the plan, then the current or former employee may receive a benefit arising from the repeal of

§ 415(e).

Q-4: How is the maximum permissible benefit increase calculated for a current or former employee who has commenced benefits under a defined benefit plan prior to the effective date of the repeal of § 415(e) for the plan?

A-4: For any limitation year beginning on or after the effective date of the repeal of § 415(e) for the plan, the benefit payable to any current or former employee who has commenced benefits under the plan prior to that date in a form not subject to § 417(e)(3) may be increased to a benefit that is no greater than the benefit that would have been permitted for that year under § 415(b) for the employee had § 415(e) not limited the benefit at the time of commencement. Thus, the annual benefit for limitation years beginning on or after the effective date of the repeal of § 415(e) for the plan is limited to the § 415(b) limitation for the employee (increased for the cost-of-living-adjustments, if the plan provided for such adjustments) based on the employee's age at the time of commencement. In the case of a form of benefit that is subject to § 417(e)(3), the benefit payable for any limitation year beginning on or after the effective date of the repeal of § 415(e) for the plan may be increased by an amount that is actuarially equivalent to the amount of increase that could have been provided had the benefit been paid in the form of a straight life annuity. Whether or not the form of benefit is subject to § 417(e)(3), benefits attributable to limitation years beginning before January 1, 2000, cannot reflect benefit increases that could not be paid for those years because of § 415(e). In addition, any plan amendment to provide an increase as a result of the repeal of § 415(e) can be effective no earlier than the effective date of the repeal of § 415(e) for the plan. The following examples illustrate these principles:

*Example 1:* Plan *M*, a defined benefit plan, has a calendar plan year and limitation year. Plan *M* is not a top-heavy plan during any relevant period. Under Plan *M*, participants may elect to receive benefit distributions either in the form of an annuity or a single sum. Plan M provides that benefits for retirees are increased as the dollar limitation is indexed under § 415(d) of the Code. Plan *M* also provides that benefits will be limited to the extent necessary to satisfy the requirements of § 415(e). In order to reflect the § 417(3)(3) change made by GATT, Plan *M* was amended on January 1, 1995, effective as of that date, to substitute the applicable interest rate and 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. Additionally, Plan *M* was amended on July 1, 1998 effective as of January 1, 1995, to apply the § 415(b)-(2)(E) changes made by GATT and SBJPA to all benefits under the plan on or after the RPA '94 § 415 effective date, as defined in Rev. Rul.98–1, 1998–2 I.R.B. 5. Under Plan *M*, early retirement benefits and other optional forms of benefit are determined as the actuarial equivalents of a straight life annuity at normal retirement age using the applica-

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## Elimination of 415(e), Continued from page 5

ble interest rate and applicable mortality table. For purposes of this example, the applicable interest rate for all relevant periods is assumed to be 6 percent.

*P* was a participant both in Plan *M*, and in Plan *N*, a defined contribution plan, before retiring at the end of 1995. *P* is unmarried and has a date of birth of January 1, 1940, *P's* social security retirement age is 66. *P* commenced receiving distributions from Plan *M* in the form of a single life annuity on January 1, 1996, at age 56. The dollar limitation of § 415(b)(1)(A) for 1996 was $120,000. *P's* compensation-based limit under § 415(b)(1)(B) was $150,000 for all relevant periods. Accordingly, the $150,000 for all relevant periods. Accordingly, the § 415(b)(1)(A) for 1996 was $120,000. *P's* compensation-based limit under § 415(b)(1)(B) was $150,000 for all relevant periods. Accordingly, the § 415(b) limitation for *P's* benefit in 1996 was $54,753 ($120,000 reduced for early retirement at age 56).

*P's* defined contribution fraction for 1996 was 0.36. Therefore, in order to comply with § 415(e) in the manner provided under the plan. *P's* benefit in Plan *M* was limited so that *P's* defined benefit fraction was equal to 0.64 (1 minus 0.36). Thus *P's* benefit in 1996 was limited to $43,802 (0.64 multiplied by the lesser of (A) 1.25 multiplied by $54,753 or (B) 1.4 multiplied by $150,000).

The dollar limitation under § 415(b)(1)(A) increased to $125,000 in 1997, and to $130,000 in 1998 and 1999. In 1997, because of the indexing of the dollar limitation under plan *M, P's* benefit was increased to $45,628. Similarly, in 1998, *P's* benefit was increased to $47,453. In 1999, because the dollar limitation was unchanged from 1998, *P's* benefit continued to be limited to $47,453. For purposes of this example, it is assumed that the § 415(b)(1)(A) dollar limitation will be $135,000 in 2000.

Effective January 1, 2000, *P's* annuity payments under Plan *M* are permitted to be increased to a maximum annuity benefit of $61,597 ($135,000 reduced for early retirement at age 56). However, no increase in *P's* benefit is permitted to reflect the difference between the limitation of § 415(b) and the limitation of § 415(e) in prior limitation years.

Alternatively, if Plan *M* had not provided that benefits for retirees are increased as the dollar limitation is indexed under § 415(d) of the Code, but was amended to provide for such increases effective for the limitation year beginning January 1, 2000, *P's* benefit could be increased from $43,802 (the benefit without adjustment for increases in the § 415(b)(1)(A) dollar limitation) to $61,597, plus the annual amount that is actuarially equivalent to the $9,128 that could have been in the prior limitation years ($1,826 for 1997, and $3,651 each for 1998 and 1999) had the plan provided for benefit increases to reflect the cost-of-living increases under § 415(d).

*Example 2:* Assume the same facts as in *Example 1*, except that Plan *M* does not provide that benefits for retirees are increased as the dollar limitation is indexed under § 415(d) of the Code, and *P* commenced distributions from Plan *M* in the form of ten equal annual installments commencing on January 1, 1996. Accordingly, the § 415(b) limitation for *P's* benefit in 1996 was $89,635 ($120,000 reduced for early retirement at age 56 and adjusted for the installment option). In order to comply with § 415(e). *P's* installment payment in 1996 was limited to $71,707. Similarly, for the years 1997 through 1999, *P* received installment payments of $71,707. As of January 1, 2000, *P* has six installment payments remaining. Because Plan *M* does not provide for cost-of-living adjustments under § 415(d). *P's* six remaining installment payments under Plan *M* are permitted to be increased, effective January 1, 2000, by the actuarial equivalent (spread over a period of six years) of the value of the increases in the single life annuity that would have been payable beginning on January 1, 2000 (i.e., the increase from $43,802 to $54,753) if *P* had elected a single life annuity rather than the installment payment option.

If Plan *M*, however was amended to provide for cost-of-living adjustments under § 415(d), effective January 1, 2000, then *P's* six remaining installment payments would be permitted to be increased by the actuarial equivalent (spread over a period of six years) of the value of the increases in the single life annuity that would have been payable beginning on January 1, 2000 (i.e., the increase from $43,802 to $61,597) if *P* had elected a single life annuity rather than the installment payment option. Furthermore, Plan *M* could provide that each of *P's* six remaining installment payments under Plan *M* are increased by the actuarial equivalent (spread over six years) of the value of the increases in the prior installment payment that would have been paid in the prior limitation years had the plan provided by increases in the installment payments to reflect the increases under § 415(d).

Q-5: How will a plan that takes into account the repeal of § 415(e) as of the first day of the first limitation year beginning on or after January 1, 2000, satisfy the nondiscrimination in amount of benefits requirements?

A-5: A plan that uses the safe harbor and takes into account the repeal of § 415(e) as of the first day of the first limitation year beginning on or after January 1, 2000, will not fail to satisfy the uniformity requirements of §§ 1.401(a)(4)-2(b) or 1.401(a)(4)-3(b)(2) merely because the repeal of § 415(e) is taken into account under the plan.

For purposes of the general test for nondiscrimination in amount of contributions, increased contributions allocated under the terms of a defined contribution plan due to the repeal of § 415(e) must be taken into account in accordance with the rules of § 1.401(a)(4)-2(c)(2)(ii) for the plan year for which the increased allocations are made. For purposes of the general test for nondiscrimination in amount of benefits, increased benefits provided to an employee under the terms of a defined benefit plan due to the repeal of § 415(e) must be included as increases in the employee's accrued benefit (within the meaning of § 411(a)(7)(A)(i) and the employee's most valuable optional form of payment of the accrued benefit (within the meaning of § 1.401(a)(4)-3(d)(1)(ii)) in accordance with the rules of § 1.401(a)(4)-3(d), and must be included in the computation of both the normal and most valuable accrual rates for any measurement period that includes the plan year for which the increase occurs. If the limitations of § 415 are taken into account in testing the plan for limitation years beginning on or after January 1, 2000, those limitations must reflect the repeal of § 415(e).

Q-6: If benefit increases are provided to employees and former employees under a plan as a result of the repeal of § 415(e), how are the requirements of §§ 1.401(a)(4)-5 and 1.401(a)(4)-10 of the regulations satisfied?

A-6: If benefit increases resulting from the repeal of § 415(e) are provided, as of the effective date of the repeal of § 415(e) for the plan, to either (1) all current and former employees who have an accrued benefit under the plan immediately before the effective date of the repeal of § 415(e) for the plan, or (2) all employees participating in the plan that have one hour of service after the effective date of the repeal of § 415(e) for the plan, through the adoption of a plan amendment, then the timing of such an amendment satisfies the requirements of § 1.401(a)(4)-5 of the regulations, and the requirements of § 1.401(a)(4)-10(b) of the regulations are satisfied. In addition, if benefit increases are provided, as of the effective date of the repeal of § 415(e) for the plan, to either of the two groups described in the preceding sentence through the operation of the plan's existing provisions, then the requirements of §§ 1.041(a)(4)-5 and 1.401(a)(4)-10(b) of the regulations are satisfied.

If benefit increases due to the repeal of § 415(e) are provided only to a certain group of current or former employees not described in the preceding paragraph through the adoption of a plan amendment, or if a plan amendment to reflect the repeal of § 415(e) is effective as of a later date than the effective date of the repeal of § 415(e) for the plan, then the timing of such an amendment (considered in conjunction with the effect of the repeal of § 415(e) ) must satisfy a facts-and-circumstances determination under § 1.401(a)(4)-5(a)(2) of the regulations, and the requirements of § 1.401(a)(4)-10 must be applied.

Q-7: May a plan be amended to limit the extent to which a participant's benefit would otherwise automatically increase under the terms of the plan as a result of the repeal of § 415(e)?

A-7: Yes, a plan may be amended to limit the extent to which a participant's benefit would otherwise automatically increase under the terms of the plan as a result of the repeal of § 415(e). However, see Q&A-8 for certain qualification requirements that may be affected by such an amendment. A plan sponsor may wish to make a plan amendment to preclude a benefit

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## Elimination of 415(e), Continued from page 6

increase that would otherwise occur as a result of the repeal of § 415(e) in order to provide time for the plan sponsor to consider the extent to which a benefit increase relating to the repeal of § 415(e) should or should not be provided at some later date consistent with all relevant qualification requirements. A plan amendment to limit the extent to which such a benefit increase would otherwise occur that is not both adopted prior to, and effective as of, the first day of the first limitation year beginning on or after January 1, 2000, may fail to satisfy § 411(d)(6). Therefore, a plan amendment that is intended to limit such a benefit increase should be both adopted prior to, and effective as of, the first day of the first limitation year beginning on or after January 1, 2000 (even though the plan could be later amended during the plan's remedial amendment, at the option of the plan sponsor, to retroactively provide for the benefit increase). The following is an example of language that could be used by a plan sponsor, on an interim or permanent basis, in amending a defined benefit plan that would otherwise provide for a benefit increase due to the repeal of § 415(e), to retain the effect of the pre-SBJPA § 415(e) limitations in determining a participant's accrued benefit under the plan (without failing to satisfy § 411(d)(6)):

*Effective as of the first day of the first limitation year beginning on or after January 1, 2000 (the "Effective Date"), and notwithstanding any other provision of the Plan, the accrued benefit for any participant shall be determined by applying the terms of the Plan implementing the limitations of § 415 as if the limitations of § 415 continued to include the limitations of § 415(e) as in effect on the day immediately prior to the Effective Date. For this purpose, the defined contribution fraction is set equal to the defined contribution fraction as of the day immediately prior to the Effective Date.*

Q-8: Are there qualification requirements that may not be satisfied if a plan continues to limit benefits after the first day of the first limitation year beginning on or after January 1, 2000, using the pre-SBJPA § 415(e) limitations?

A-8: There are some qualification requirements that may not be satisfied for a plan if the plan continues to limit benefits after the first day of the first limitation year beginning on or after January 1, 2000, using the pre-SBJPA § 415(e) limitations. Any exception from the otherwise applicable qualification rules that is permitted solely in order to satisfy the maximum limitations on contribution or benefits under § 415 with respect to a participant does not apply if the participant's contributions or benefits are below the limitations of § 415(e). Thus, such an exception is not permitted where a plan limits benefits in a manner that is more restrictive than required under § 415(e). For example, at any time on or after the first day of the first limitation year beginning on or after January 1, 2000, a qualified defined contribution plan could not provide that the provision of § 1.415-6(b)(6) would be applied to place an amount that does not exceed the limitations under § 415, but that does exceed the pre-SBJPA § 415(e) limitations, in an unallocated suspense account as an excess annual addition. Similarly, a qualified cash or deferred arrangement could not provide that the provision of § 415–6(b)(6)(iv) would be applied to permit the distribution of elective deferrals that do not exceed the limitations under § 415, but that exceed the pre-SBJPA § 415(e) limitations. See Q&A-10 for a description of the effects that the continued application of the pre-SBJPA § 415(e) limitations may have on the requirements for nondiscrimination testing. Additionally, if a participant's annual additions to a defined contribution plan result in a decrease in the participant's accrued benefit under a defined benefit plan (under the terms of both plans), the relief previously provided under Q&A G-10 of Notice 83-10, 1983-1 C.B. 536 no longer applies, and such a reduction would violate § 411.

The qualification issues described in the Q&A-8 may arise whenever a lower limitation is applied under a plan in lieu of a statutory § 415 limitation that applies for the limitation year. For example, the issues described in this Q&A-8 may arise if a lower limitation is applied under a plan as a result of using a definition of compensation that is not within the meaning of § 415(c)(3), as amended by SBJPA. Q&A-9 provides § 7805(b)(8) relief that applies where a plan uses the pre-SBJPA § 415(c)(3) definition of compensation instead of current § 415(c)(3) definition.

Q-9: To the extent that a qualified defined contribution plan applies the rules in § 1.415-6(b)(6) with respect to excess annual additions, must the plan apply the rules in § 1.415-6(b)(6) using a definition of compensation within the meaning of § 415-(c)(3) as amended by SBJPA?

A-9: For limitation years ending on or after December 1, 1999, to the extent that a plan applies the rules in § 1.415-6(b)(6), a defined contribution plan will not satisfy the requirements of § 4016(a) unless the rules of § 1.415-6(b)(6) are applied using a definition of compensation within the meaning of § 415(c)(3) as amended by SBJPA. However, for limitation years ending on or before November 30, 1999, pursuant to § 7805(b)(8), the Service will not treat a defined contribution plan as failing to satisfy the requirements of § 401(a) merely because the rules in § 1.415-6(b)(6) are applied using a definition of compensation within the meaning of § 415(c)(3) prior to its amendment by SBJPA.

Q-10: How may a plan that continues to limit benefits after the first day of the first limitation year beginning on or after January 1, 2000, using the pre-SBJPA § 415(e) limitations, satisfy the nondiscrimination in amount of benefits requirement?

A-10: A plan does not fail to satisfy the uniformity requirements of §§ 1.401(a)-(4)–2(b) or 1.401(a)(4)–3(b)(2) merely because the limitations under § 415 are taken into account under the safe harbor requirements. The continued application of the pre-SBJPA § 415(e) limitations for a plan year after the effective date of the repeal of § 415(e) for a plan would cause the plan to fail to satisfy the uniformity requirements for the otherwise applicable nondiscrimination in amount safe harbor. However, if a plan limits benefits at any time on or after the first day of the first limitation year beginning on or after January 1, 2000, using the pre-SBJPA § 415(e) limitations for highly compensated employees (but not for nonhighly compensated employees), the plan will not fail to satisfy the uniformity requirements and thus will not fail to satisfy a nondiscrimination in amount safe harbor merely because of this limited application of the pre-SBJPA § 415(e) limitations. See §§ 1.401(a)(4)–2(b)(4)(v) and 1.401(a)-4(4)–3(b)(6)(x) of the regulations.

If a plan continues to limit benefits on or after the first day of the first limitation year beginning on or after January 1, 2000, using the pre-SBJPA § 415(e) limitations, the annual additions or accrued benefits that are taken into account in performing the general tests for nondiscrimination in amount of contributions or benefits must reflect the plan provisions that limit benefits in this manner.

Q-11: How is the repeal of § 415(e) treated under the plan for purposes of § 412?

A-11: For purposes of § 412, any increase in the liabilities of a plan as a result of the repeal of § 415(e) must be treated as occurring pursuant to a plan amendment effective no earlier than the first day of the first limitation year beginning on or after January 1, 2000 (whether the increase in liabilities under the terms of the plan arises pursuant to a plan amendment, or pursuant to existing plan provisions, e.g., where benefits automatically increase as of the effective date of the repeal of § 415(e) for the plan). Accordingly, any amortization base that is established under § 412 for an increase in liabilities under a plan resulting from the repeal of § 415(e) must have an amortization period of 30 years. A plan amendment that makes the repeal of § 415(e) effective for a plan cannot be taken into account for purposes of § 412 prior to the effective date of the repeal of § 415(e) for the plan.

Q-12: What is the effect of the repeal of § 415(e) on an "old-law benefit" defined in Q&A-12 of Rev. Rul. 98-1, 1998-2 I.R.B. 5?

A-12: Under Q&A-13 of Rev. Rul. 98-1, a participant's old-law benefit under a plan is determined as of a specified freeze date that precedes the final implementation date for the plan. Under Q&A-15 of Rev. Rul. 98-1, a participant's old-law benefit cannot increase after the participant's freeze date. Under Q&A-12 of Rev. Rul. 98-1, the final implementation date for the plan cannot be later than the first day of the first limitation year beginning after December 31, 1999. Because the freeze date must precede the final implementation date, the latest possible freeze date under a plan is the day before the first day of the first limitation year beginning after December 31, 1999. Thus, the latest possible freeze

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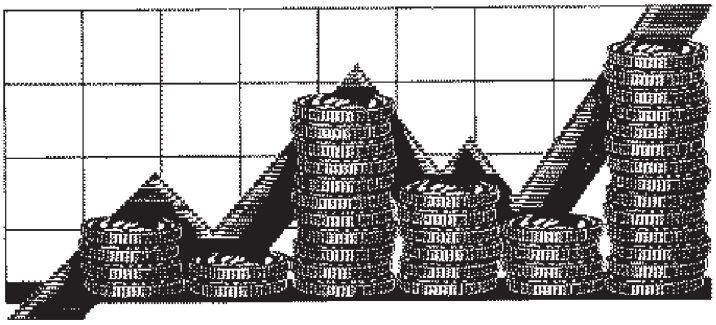
# IRS UPDATES ACTUARIAL NUMBERS—VALUATION OF ANNUITIES



In 1986, section 7520(c)(3) of the Internal Revenue code was changed so the Secretary of the Treasury is required to update the actuarial tables to reflect the most recent mortality experience. The Secretary's first deadline was to furnish such tables no later than 12-31-89 and then not less frequently than once every 10 years.

The IRS met the first deadline when it issued Publication 1457—Actuarial Values Alpha Volume in August of 1989.

It is now 10 years later. The IRS has recently issued temporary regulations to adopt revised actuarial tables. These regulations incorporate revised Table S (Single Life Remainder Factors) as based on data compiled from the 1990 census as set forth in life Table 90CM. The prior table was 80CNSMT.

What is the impact on IRAs?

These tables are primarily used for "estate" tax law purposes. The effective date for using the new tables is 5-1-99.

As is well known, the IRS indicated in Notice 89-52 that an annuity factor method could be used by an IRA accountholder who was younger than age 59 1/2 to establish a substantially equal periodic payment distribution schedule so that the 10% additional tax of Code section 72(t) would not apply.

Some software producers chose to use the annuity factors from Table S (80CNSMT) for the annuity factor method (i.e. the old factors). CWF designed its MINCAL software to use these factors. The IRS has now changed Table S. Therefore, our MINCAL software and the software of others should be changed. CWF is in the process of updating its software and we should be done within 45 days.

The IRS' new actuarial tables confirm the expected. People are living longer. The effect of this on the tables is—the 90CM annuity factors are somewhat larger than the "old" 80CNSMT factors. Since the factor is a divisor and the divisor has become larger, the annual substantially equal periodic payment will be slightly smaller. This is to be expected since if a person lives longer, the payment schedule becomes a little longer and the distribution amount a little smaller.

For example: An IRA accountholder has an IRA balance of $75,000 as of 7-15-99. The IRA accountholder is age 40. The current interest rate is 5.0%. Under the "old" tables, his annuity factor would have been 15.8691, and his annual distribution amount would have been $6,301.55. Under the "new" tables, his annuity factor is 16.0968, and his annual distribution amount is $5,893.45.

### Effect on Old and New Schedules

We believe an IRA custodian will not need to re-do or recalculate older substantially equal payments which were calculated by using the "old" annuity factors, because the tables in effect at the time the distribution commenced continue to be the correct tables.

However, you should start to use the new tables as soon as possible for those substantially equal periodic payment schedules to be set up for the remainder of 1999 and subsequently. The IRS has made it difficult for all of us because the IRS will not have the printed Publication 1457 available until possibly the end of this year. ◆

### Elimination of 415(e), Continued from page 7

date for a plan is the day before the effective date of the repeal of § 415(e) for the plan. As a result, the repeal of § 415(e) generally will have no effect on the amount of a participant's old-law benefit, as the old-law benefit would be determined prior to the effective date of the repeal of § 415(e) for the plan. Nevertheless, if the old-law benefit for a participant in a defined benefit plan was reduced during the period between the freeze date and the effective date of the repeal of § 415(e) for the plan because of annual additions credited to a participant's account in an existing defined contribution plan, the old-law benefit may increase to the freeze-date level as of the effective date of the repeal of § 415(e) for the plan.

Q-13: Are the requirements of § 415(b)(4)(B) affected by the repeal of § 415(e)?

A-13: No. Section 415(b)(4)(B) generally provides that the limitation on benefits under a defined benefit plan under § 415(b) with respect to a participant cannot be less than $10,000, but only if the employer has not at any time maintained a defined contribution plan in which the participant participated. The statutory provision repealing § 415(e) did not modify § 415(b)(4)(B). Accordingly, the requirements of § 415(b)(4)(B) are unaffected by the repeal of § 415(e).

Q-14: How will the repeal of § 415(e) affect the regulations relating to § 403(b)?

A-14: Under § 415(c)(4)(D) and the regulations regarding the exclusion allowance under § 403(b)(2), an employee may elect to have the provisions of § 415(c)(4)(C) apply for a taxable year. If the employee so elects, the employee's exclusion allowance is the maximum amount under § 415 that could be contributed by the employer for the benefit of the employee if the annuity contract for the benefit of the employee were treated as a defined contribution plan maintained by the employer. The fourth sentence of § 1.403(b)-1(d)(5) provides that the rules under § 415(e) apply where such an election is made. Section 1504(b) of the Taxpayer Relief Act of 1997, Pub. L. 105-34, provides that regulations regarding the exclusion allowance under § 403(b)(2) of the Code shall be modified to reflect the repeal of § 415(e). Accordingly, the Commissioner intends to modify the regulations such that the fourth sentence of § 1.403(b)-1(d)(5) does not apply after the effective date of the repeal of § 415(e). ◆