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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-209500-86, REG-164464-02]

RIN 1545-BA10,1545-BB79

Reductions of Accruals and Allocations Because of the Attainment of Any Age; Application of Nondiscrimination Cross-Testing Rules to Cash Balance Plans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations that would provide rules regarding the requirements that accruals or allocations under certain retirement plans not cease or be reduced because of the attainment of any age. In addition, the proposed regulations would provide rules for the application of certain nondiscrimination rules to cash balance plans. These regulations would affect retirement plan sponsors and administrators, and participants in and beneficiaries of retirement plans. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments, requests to speak and outlines of oral comments to be discussed at the public hearing scheduled for April 9, 2003, at 10 a.m., must be received by March 13, 2003.

ADDRESSES: Send submissions to: CC:ITA:RU (REG-209500-86), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered to: CC:ITA:RU (REG-209500-86), room

5226, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by submitting comments directly to the IRS Internet site at: www.irs.gov/regs. The public hearing will be held in room 4718, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Linda S. F. Marshall, 202-622-6090, or R. Lisa Mojiri-Azad, 202-622-6030; concerning submissions and the hearing, and/or to be placed on the building access list to attend the hearing, Sonya Cruse, 202-622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 401 and 411 of the Internal Revenue Code of 1986 (Code). Section 411(b)(1)(H), which was added in subtitle C of the Omnibus Budget Reconciliation Act of 1986 (OBRA ‘86) (100 Stat. 1874), provides that a defined benefit plan fails to comply with section 411(b) if, under the plan, an employee’s benefit accrual is ceased, or the rate of an employee's benefit accrual is reduced, because of the attainment of any age. Under section 411(b)(2)(A), added by subtitle C of OBRA ‘86, a defined contribution plan fails to comply with section 411(b) unless, under the plan, allocations to the employee’s account are not ceased, and the rate at which amounts are allocated to the employee's account is not reduced, because of the attainment of any age.

Section 411(b)(1)(H)(iii) provides that any requirement of continued accrual of benefits after normal retirement age is treated as satisfied to the extent benefits are distributed to the participant or the participant's benefits are actuarially increased to reflect the delay in the distribution of benefits after attainment of normal retirement age. Section 411(a) requires a qualified plan to meet certain vesting requirements. In the case of a participant in a defined benefit plan who works after attaining normal retirement age, these vesting requirements are not satisfied unless the plan provides an actuarial increase after normal retirement age for accrued benefits, distributes benefits while the participant is working after normal retirement age, or suspends benefits as described in section 411(a)(3)(B) (and the regulations of the Department of Labor at 29 CFR 2530.203-3). Section 401(a)(9)(C)(iii), added to the Code by the Small Business Job Protection Act of 1996 (110 Stat. 1755) (1996), requires that the accrued benefit of any employee who retires after age 70½ be actuarially increased to take into account the period after age 70½ during which the employee is not receiving benefits.

Section 4(i) of the Age Discrimination in Employment Act (ADEA) and sections 204(b)(1)(H) and 204(b)(2) of the Employee Retirement Income Security Act of 1974 (ERISA) provide requirements comparable to those in sections 411(b)(1)(H) and 411(b)(2) of the Code. Section 4(i)(4) of ADEA provides that compliance with the requirements of section 4(i) with respect to an employee pension benefit plan constitutes compliance with the requirements of section 4 of ADEA relating to benefit accrual under the plan.

Under section 101 of Reorganization Plan No. 4 of 1978 (43 FR 47713), the Secretary of the Treasury has interpretive jurisdiction over the subject matter addressed in these regulations for purposes of ERISA, as well as the Code. Therefore, these regulations apply for purposes of the parallel requirements of sections 204(b)(1)(H) and 204(b)(2) of ERISA, as well as for section 411(b) of the Code.

The Equal Employment Opportunity Commission (EEOC) has jurisdiction over section 4 of ADEA. Section 9204(d) of OBRA '86 requires that the regulations and rulings issued by the Department of Labor, the Treasury Department, and the EEOC pursuant to the amendments made by subtitle C of OBRA '86 each be consistent with the others. It further requires the Secretary of Labor, the Secretary of the Treasury, and the EEOC to each consult with the others to the extent necessary to meet the requirements of the preceding sentence. Executive Order 12067 requires all Federal departments and agencies to "advise and offer to consult with the Equal Employment Opportunity Commission during the development of any proposed rules, regulations, policies, procedures or orders concerning equal employment opportunity." The IRS and Treasury have consulted with the Department of Labor and the EEOC prior to the issuance of these proposed regulations under sections 411(b)(1)(H) and 411(b)(2) of the Code.

The EEOC published proposed regulations interpreting section 4(i) of ADEA in the **Federal Register** on November 27, 1987 (52 FR 45360). Proposed regulations REG-209500-86 (formerly EE-184-86) under sections 411(b)(1)(H) and 411(b)(2) were previously published by the IRS and Treasury in the **Federal Register** on April 11, 1988 (53 FR 11876), as part of a package of regulations (the 1988 proposed regulations) that also included proposed regulations under sections 410(a), 411(a)(2), 411(a)(8) and 411(c) (relating to maximum age for participation, vesting, normal retirement age, and actuarial adjustments after normal retirement age). The IRS, Treasury, the Department of Labor, and the EEOC consulted prior to the issuance of both sets of proposed regulations.

Notice 88-126 (1988-2 CB 538), addressed certain effective date issues for sections 411(b)(1)(H) and 411(b)(2). The EEOC issued a similar notice addressing those effective date issues in the **Federal Register** on January 9, 1989 (54 FR 604). The United States Supreme Court subsequently issued an opinion addressing the effective date of section 411(b)(1)(H) in Lockheed Corp. v. Spink, 517 U.S. 882 (1996), which is discussed below.

On October 20, 1999, the IRS and Treasury published a solicitation for comments in the **Federal Register** (64 FR 56578) inviting comments regarding potential issues under their jurisdiction with respect to cash balance plans (a type of defined benefit plan under which the normal form of benefit is an immediate payment of a participant's hypothetical account, which is adjusted periodically to reflect pay credits and interest credits), conversions of traditional defined benefit plans to cash balance plans and associated wear-away or benefit plateau effects. Hundreds of comments were received from a wide range of parties with interests in cash balance plans, including employees, employers, and their representatives. The most significant issue raised in the comments relates to the application of section 411(b)(1)(H) to cash balance plans and conversions of traditional defined benefit plans to cash balance plans.

These proposed regulations are being issued after consideration of the comments on the 1988 proposed regulations, as well as more recent comments concerning the application of sections 411(b)(1)(H) and 411(b)(2). These proposed regulations address the application of section 411(b)(1)(H) to cash balance plans, including conversions.

These proposed regulations would also amend the provisions of the regulations under section 401(a)(4) to provide rules for nondiscrimination testing for certain cash balance plans.

Explanation of Provisions

Overview

These proposed regulations provide guidance on the requirements of section 411(b)(1)(H), under which a defined benefit plan fails to be a qualified plan if, under the plan, benefit accruals on behalf of a participant are ceased or the rate of benefit accrual on behalf of a participant is reduced because of the participant's attainment of any age.[1] Similarly, these proposed regulations provide guidance on the requirements of section 411(b)(2), under which a defined contribution plan fails to be a qualified plan if, under the plan, allocations to a participant's account are ceased or the rate of allocations to a participant's account is reduced because of the participant's attainment of any age.

These proposed regulations follow the 1988 proposed regulations in many respects. In particular, these proposed regulations would adopt many of the positions taken under the 1988 proposed regulations for determining whether a plan ceases benefit

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[1]While section 4(i) of the ADEA, section 204(b)(1)(H) of ERISA, and section 411(b)(1)(H) of the Code are worded similarly, the words “attainment of any” are not in section 4(i) of the ADEA. The legislative history states that no differences among the provisions is intended (OBRA 86 House Report No. 99-727 at 378-9), and the agencies have concluded that this particular difference in language has no effect.

accruals or allocations because of the attainment of any age or provides for a direct or indirect reduction in the rate of benefit accrual or allocation because of the attainment of any age.

These proposed regulations also provide guidance on how to determine the rate of benefit accrual or rate of allocation. In the case of defined benefit plans, the proposed regulations would provide two basic approaches to determining the rate of benefit accrual: a general approach applicable to all defined benefit plans; and a separate approach applicable to eligible cash balance plans, as defined in these proposed regulations. These proposed regulations also provide guidance on determining the rate of allocation under a defined contribution plan.

Finally, these proposed regulations address other related issues also addressed in the 1988 proposed regulations, including the application of sections 411(b)(1)(H) and 411(b)(2) to optional forms of benefits, ancillary benefits and other rights and features, the coordination of the requirements of sections 411(b)(1)(H) and 411(b)(2) with certain other qualification requirements under the Code, such as sections 401(a)(4), 411(a), and 415, and the effective date of sections 411(b)(1)(H) and 411(b)(2).

<u>Applicability Prior to Normal Retirement Age</u>

Sections 411(b)(1)(H) and 411(b)(2) prohibit cessation of accruals or allocations, and reduction in the rate of benefit accrual or allocation, because of the attainment of any age. Under these sections, attainment of any age means a participant’s growing older. Accordingly, these regulations, like the 1988 proposed regulations, would apply regardless of whether the participant is older than, younger than, or at normal retirement age.

Some commentators have suggested that only cessations or reductions after attainment of normal retirement age are prohibited by these sections. This interpretation is not consistent with the language of the statute, which does not specify any minimum age at which the rule applies, and is not adopted under these proposed regulations.

Reduction in Rate of Benefit Accrual Because of Attainment of Any Age

Under these proposed regulations, a defined benefit plan fails to comply with section 411(b)(1)(H) if, either directly or indirectly, a participant's rate of benefit accrual is reduced (which includes a cessation of participation in the plan or other discontinuance of benefit accruals) because of the participant's attainment of any age. A plan provides for a reduction in the rate of benefit accrual that is directly because of the attainment of any age if, during a plan year, under the terms of the plan, any participant's rate of benefit accrual for the plan year would be higher if the participant were younger. Thus, a plan fails to comply with section 411(b)(1)(H) if, under the terms of the plan, the rate of benefit accrual for any individual who is or could be a participant under the plan would be lower solely as a result of such individual being older. Whether there is an actual participant at any particular age is not relevant. Similarly, whether a reduction in the rate of benefit accrual is because of the attainment of any age does not depend on a comparison of a participant's rate of benefit accrual for a year to that participant's rate of benefit accrual in an earlier year. These proposed regulations include a number of examples (at §1.411(b)-2(b)(3)(iii) of these regulations) which illustrate whether a reduction in the rate of benefit accrual is because of the attainment of any age.

A reduction in the rate of benefit accrual is indirectly because of a participant's attainment of any age if any participant's rate of benefit accrual for the plan year would be higher if the participant were to have a different characteristic that is a proxy for being younger, based on all the relevant facts and circumstances. For example, if a company assigns older workers to one division and younger workers to another even though they perform the same work, then assignment to a division would be a proxy for being older or younger.

Like the 1988 proposed regulations, these proposed regulations provide that a reduction in a participant's rate of benefit accrual is not indirectly because of the attainment of any age in violation of section 411(b)(1)(H) solely because of a positive correlation between attainment of any age and a reduction in the rate of benefit accrual. In addition, a defined benefit plan does not fail to satisfy section 411(b)(1)(H) solely because, on a uniform and consistent basis without regard to a participant's age, the plan limits the amount of benefits a participant may accrue under the plan or limits the number of years of service or participation taken into account for purposes of determining the accrual of benefits under the plan, whether the plan reduces or ceases accruals for service in excess of such limit. A limitation that is expressed as a percentage of compensation (whether averaged over a participant's total years of credited service for the employer or over a shorter period) is a permissible limitation on the amount of benefits a participant may accrue under the plan.

Rate of Benefit Accrual

Neither section 411(b)(1)(H) nor the 1988 proposed regulations define the rate of benefit accrual. These proposed regulations would provide two basic approaches to determining the rate of benefit accrual, based on the way the benefit is expressed in the plan. One approach may be used by all defined benefit plans. A second approach may be used only by an eligible cash balance plan, as defined in these proposed regulations.

Under the general rule, the rate of benefit accrual for any plan year that ends before the participant attains normal retirement age is the increase in the participant's accrued normal retirement benefit for the year. Because the rate of benefit accrual is determined by reference to the increase in the accrued benefit during the plan year, any subsidized portion of an early retirement benefit, any qualified disability benefit, or any social security supplement is disregarded.

Section 411(b)(1)(H)(iii)(II) provides that a defined benefit plan does not fail to comply with section 411(b)(1)(H) for a plan year to the extent of any adjustment in the benefit payable under the plan during such plan year attributable to the delay in the distribution of benefits after the attainment of normal retirement age. These proposed regulations implement this rule (i.e., permit a plan to offset any actuarial adjustment during the year against the otherwise required accruals under the plan), by providing that the rate of benefit accrual after normal retirement age is equal to the excess, if any, of the annual benefit to which the participant is entitled at the end of the plan year over the annual benefit to which the participant would have been entitled at the end of the preceding plan year. For this purpose, the annual benefit is determined assuming that payment commences in the normal form of benefit under the plan at the end of the applicable year. For purposes of these proposed regulations, the normal form of benefit is the form under which payments due to the participant are expressed under the plan, prior to adjustment for form of benefit.

The methodology of determining a year-by-year rate of accrual, taking into account any actuarial increases during the plan year, is a departure from the methodology used in the 1988 proposed regulations. As a consequence of the methodology used in these proposed regulations, the plan may not reduce a participant's rate of benefit accrual in a plan year to take into account the fact that, in the preceding plan year, the actuarial increase was greater than the accrual under the plan formula.

While any actuarial adjustment made to the annual benefit to which the participant would have been entitled at the end of the preceding plan year is included in the rate of benefit accrual after normal retirement age, a defined benefit plan must separately comply with the requirements of section 411(a), which are not addressed in these proposed regulations. Thus, for example, a plan that does not provide for suspension of benefits in accordance with section 411(a)(3) must provide for actuarial adjustments of the amount that would otherwise be paid (or distributions of that amount) that are adequate to satisfy section 411(a) and 29 CFR 2530.203-3 of the regulations of the Department of Labor. In addition, the plan must comply with section 401(a)(9)(C)(iii) with respect to actuarial adjustments for participants who retire after attainment of 70½.

Section 411(b)(1)(H)(iii)(I) provides that a defined benefit plan will not fail to satisfy section 411(b)(1)(H) to the extent of the actuarial equivalent of in-service distribution of benefits. Under these proposed regulations, the rate of benefit accrual for a participant who has attained normal retirement age may be reduced by the actuarial value of plan benefit distributions made during the year. This reduction is the equivalent of the provision described above under which a defined benefit plan may offset any actuarial adjustment during the year against the otherwise required accruals for the year. As described immediately below, the manner in which distributions made under the plan are taken into account for a plan year under these regulations is designed so that compliance with section 411(b)(1)(H) is not affected by the optional form in which the distribution is made.

In the plan year during which a distribution is made, distributions are taken into account to the extent the actuarial value of the distribution does not exceed the actuarial value of distributions that would have been made during the plan year had distribution of the participant's full accrued benefit at the beginning of the plan year commenced at the beginning of the plan year (or, if later, at the participant's normal retirement age) in the normal form of benefit. Distributions in excess of the actuarial value of the distribution that would have been made during the plan year had the distribution of the participant's full accrued benefit commenced in the normal form (called accelerated benefit payments) are disregarded for that plan year, but, as described below, are taken into account in subsequent periods. If the participant is receiving a distribution in an optional form of benefit under which the amount payable annually is less than the amount payable under the normal form of benefit (for example, a QJSA under which the annual benefit is less than the amount payable annually under a straight life annuity normal form), the participant may be treated as receiving payments under an actuarially equivalent normal form of benefit.

Any accelerated benefit payments are taken into account in plan years after the plan year in which the distribution was made by converting the accelerated benefit payments to an actuarially equivalent stream of annual benefit payments under the plan's normal form of benefit distributions, commencing at the beginning of the next following plan year. This equivalent stream of annual benefit payments is then deemed to be paid in plan years after the plan year in which the distribution was made, and the calculation of the rate of benefit accrual after normal retirement age is adjusted by adding any of these deemed payments for future plan years to the annual benefit to which the participant is entitled at the end of a plan year. As so adjusted, therefore, the rate of benefit accrual is determined as the excess, if any, of the sum of the annual benefit to which the participant is entitled at the end of the plan year (assuming payment commences in the normal form at the end of the plan year) plus the annuity equivalent of accelerated benefit payments deemed paid in the next plan year, over the sum of the annual benefit to which the participant would have been entitled at the end of the preceding plan year (assuming that payment commences in the normal form at the later of normal retirement age and the end of the preceding plan year), plus the annuity equivalent of accelerated benefit payments deemed paid during the plan year. The effect of this adjustment, in the case of a single sum distribution, is to put the participant in the same position as if the participant had received the distribution in the normal form.

<u>Eligible Cash Balance Plans</u>

The 1988 proposed regulations did not contain any guidance specific to cash balance plans. A cash balance plan is a type of defined benefit plan that determines benefits by reference to an employee's hypothetical account. Since the 1988 proposed regulations were issued, the number of cash balance plans has increased. The development of cash balance plans has raised the issue of whether this design complies with section 411(b)(1)(H).

Under a cash balance plan, an employee's hypothetical account balance is credited with hypothetical allocations, often referred to as service credits or pay credits, and hypothetical earnings, often referred to as interest credits. Under some cash balance plans, the right to interest credits for future periods accrues at the same time as the pay credit (i.e., the interest credit is not contingent on the performance of services in the future). Under other cash balance plans, all or some portion of the interest credit for future periods is contingent on the performance of services in the future. The benefit under a cash balance plan is expressed in the plan document (and communicated to employees) as the hypothetical account balance, although not all cash balance plans provide a single sum distribution.

Under a cash balance plan, the interest credits for a younger participant will compound over a greater number of years until normal retirement age than for an older participant. This will result in a larger accrual for younger employees, when measured as the increase in the benefit payable at normal retirement age. Accordingly, some commentators have argued that the basic cash balance plan design violates section 411(b)(1)(H). Others have asserted that cash balance plans do not violate section 411(b)(1)(H) if the additions to the hypothetical account are not smaller because of the attainment of any age. They argue that, because pay credits under a cash balance plan are comparable to allocations under a defined contribution plan, these pay credits are an appropriate measure for testing whether a cash balance plan satisfies section 411(b)(1)(H).

These proposed regulations would provide that the rate of benefit accrual under an eligible cash balance plan, as defined in these proposed regulations, is permitted to be determined as the additions to the participant's hypothetical account for the plan year, except that previously accrued interest credits are not included in the rate of benefit accrual. Because the rate of benefit accrual is determined based on how benefits are expressed under the plan, this method of determining the rate of benefit accrual is restricted to eligible cash balance plans, as defined in these proposed regulations.

An eligible cash balance plan is a defined benefit plan that satisfies certain requirements. First, for accruals in the current plan year, the normal form of benefit is an immediate payment of the balance in a hypothetical account. As long as the normal form of benefit is an immediate payment of the balance in a hypothetical account, a plan does not fail to be an eligible cash balance plan merely because a single-sum distribution of that amount is not actually available as a distribution option under the plan.

Second, a plan is an eligible cash balance plan only if the plan provides that, at the same time that the participant accrues an addition to the hypothetical account, the participant accrues the right to future interest credits (without regard to future service) at a reasonable rate of interest that does not decrease because of the attainment of any age. Because the rate of benefit accrual under an eligible cash balance plan is generally determined by reference to additions to the hypothetical account disregarding interest credits, these interest credits must be provided for all future periods, including after normal retirement age, and an eligible cash balance plan cannot treat interest credits after normal retirement age as actuarial increases that are offset against the otherwise required accrual. A participant is not treated as having the right to future interest credits if the plan provides that additions to the hypothetical account under the plan are reduced for the actuarial equivalent of any in-service distributions because, as discussed above, such a reduction is the equivalent of an offset for an actuarial adjustment. Any additional interest credits under an eligible cash balance plan that do not accrue at the same time as the corresponding addition to the hypothetical account are included in determining the rate of benefit accrual in the year in which those additional interest credits are accrued.

In addition, a plan that is converted to a cash balance plan is subject to certain requirements, discussed below.

There are other hybrid designs that would satisfy some, but not all, of the requirements for an eligible cash balance plan. For example, there are some designs under which the normal form of benefit is the immediate payment of an account balance, but which do not provide for reasonable interest credits on that account balance. Under these proposed regulations, the rate of benefit accrual under these plans would be determined under the general rules applicable to traditional defined benefit plans.

Plans With Mixed Formulas

Some defined benefit plans have both a traditional defined benefit formula and a cash balance formula, and these proposed regulations provide rules for plans with such a mixed formula. If a portion of the plan formula under a defined benefit plan would satisfy the requirements for an eligible cash balance plan if that were the only formula under the plan, then that portion of the plan formula is referred to as an eligible cash balance formula in these proposed regulations. Any other portion of the plan formula is referred to as a traditional defined benefit formula.

The portion that is an eligible cash balance formula (or formulas if the plan has multiple eligible cash balance formulas) would be permitted to be tested using the rules for eligible cash balance plans, with the remainder of the plan tested under the rules for a traditional defined benefit formula (regardless of how many traditional defined benefit formulas the plan may have). This rule applies only if each such separately-treated plan would satisfy the maximum age conditions in section 410(a)(2) and the eligible cash balance and traditional defined benefit formulas interact in one of three specific ways for current and future accruals. The three ways are: (1) the plan provides that the participant's benefit is based on the sum of accruals under two different formulas (either sequentially where the cash balance formula goes into effect during the year or simultaneously where the plan provides for a participant to accrue benefits under both a traditional defined benefit formula and a cash balance formula at the same time with the participant to be entitled to the sum of the two); (2) the plan provides a benefit for a participant equal to the greater of the benefit determined under two or more formulas, one of which is an eligible cash balance formula and the other of which is not; or (3) under the plan, some participants are eligible for accruals only under an eligible cash balance formula and the remaining participants are eligible for accruals only under a traditional defined benefit formula or the other 2 specific methods. If the eligible cash balance formula and the traditional defined benefit formula interact in any other manner, the plan is not treated as an eligible cash balance plan for any portion of the plan formula.

Amendments Establishing an Eligible Cash Balance Formula

In many cases, a plan sponsor amends a traditional defined benefit plan to make it a cash balance plan. This process is often referred to as a “conversion.” The terms of cash balance conversions vary, but often provide an opening hypothetical account balance for each participant. In some cases, the opening balance may be based on the participant’s prior accrued benefit under the traditional defined benefit plan or on the participant’s prior service with the plan sponsor. In other cases, the opening balance is set at zero, and each participant is entitled to the sum of the participant’s accrued benefit under the traditional defined benefit plan and the cash balance account.

Some commentators have questioned whether certain cash balance conversions that provide for the establishment of an opening account balance satisfy section 411(b)(1)(H). These commentators have noted that, under section 411(d)(6), the participant can never be denied payment of the prior accrued benefit. They note that, if the opening account balance and subsequent interest credits through normal retirement age generate benefits that are not at least as large as the prior accrued benefit, the participant will not accrue net benefits for some period after the conversion. This period, often referred to as a “wear-away” period, will continue until the participant’s account balance generates benefits that exceed the prior accrued benefit. These commentators argue that the wear-away period inherently produces a lower rate of accrual for older participants.[2]

Other commentators have argued that a wear-away period does not violate section 411(b)(1)(H) because the length of the wear-away period is determined not by the participant's age but by the size of the participant's prior accrued benefit under the traditional defined benefit plan. Additionally, commentators have pointed out that, because the prior accrued benefit is calculated using an interest rate determined at the time of the amendment but the interest credits under the cash balance plan often fluctuate under a variable index, a participant may move in or out of a wear-away period after a cash balance conversion solely because of future changes in interest rates.

Under these proposed regulations, the mere conversion of a traditional defined benefit plan to a cash balance plan would not cause the plan to fail section 411(b)(1)(H). However, a converted plan that otherwise would be treated as an eligible cash balance plan must satisfy one of two alternative rules. Under the first alternative, the converted plan must determine each participant's benefit as not less than the sum of the participant's

[2] This type of wear-away differs from a wear-away that results from the fact that certain optional forms of benefit may be subsidized under the traditional defined benefit plan but not under the cash balance plan or that other actuarial factors may produce a larger benefit amount prior to normal retirement age under the traditional defined benefit plan but not under the cash balance plan. This may occur even though the actuarial value of the accrued benefit under the traditional defined benefit plan is included in the participant's opening account balance. Although section 411(d)(6) protects optional forms of benefit under the pre-amendment formula, section 411(b)(1)(H)(iv) specifically provides that a reduction because of the attainment of any age does not occur as a result of the subsidized portion of an early retirement benefit.

benefits accrued under the traditional defined benefit plan and the cash balance account. A plan satisfying this first alternative will not have a wear-away period for benefits accrued under the traditional defined benefit plan.

Under the second alternative, the converted plan must establish each participant's opening account balance as an amount not less than the actuarial present value of the participant's prior accrued benefit, using reasonable actuarial assumptions. For this purpose, an interest rate assumption is not treated as reasonable if it increases, directly or indirectly, because of the participant's attainment of any age (which would result in lower present values for older participants). This alternative does not preclude the possibility of a wear-away period for some or all the participants in the plan, but it ensures that the opening account balance of each participant reflects the actuarial value of the prior accrued benefit, determined by using reasonable assumptions. Any excess in the opening account balance over the present value of a participant's previously accrued benefit is included as part of the participant's rate of benefit accrual for the plan year, and thus is tested under section 411(b)(1)(H) along with other pay credits for the year. Effectively, this alternative provides that a converted plan will not fail to satisfy section 411(b)(1)(H) if the benefit formula before the conversion satisfies section 411(b)(1)(H), the opening account balance is based on actuarial assumptions that are reasonable (and an interest rate that does not increase for older participants), and the benefit formula after the conversion -- including any excess in the opening account balance over the present value of a participant's previously accrued benefit -- satisfies section 411(b)(1)(H).

Use of Compensation in Calculating Rate of Benefit Accrual

A participant's rate of benefit accrual for a plan year can be determined as a dollar amount. Alternatively, if a plan's formula bases a participant's accruals on current compensation, then a participant's rate of benefit accrual can be determined as a percentage of the participant's current compensation. Likewise, if a plan's formula bases a participant's accruals on average compensation, then a participant's rate of benefit accrual can be determined as a percentage of that measure of the participant's average compensation. In order for the participant's rate of benefit accrual to be determined as a percentage of the participant's current or average compensation, compensation must be determined without regard to attainment of any age. The alternative of using current or average compensation simplifies testing, without changing the result.

Defined Contribution Plans

A defined contribution plan fails to comply with section 411(b)(2) if, either directly or indirectly, because of a participant's attainment of any age, the allocation of employer contributions or forfeitures to the account of the participant is discontinued or the rate at which the allocation of employer contributions or forfeitures is made to the account of the participant is decreased. For determining if there is a cessation or reduction in allocations because of attainment of any age, these proposed regulations would adopt a substantive standard that is similar to the standard that applies under these proposed regulations for defined benefit plans and to the standard that was proposed in the 1988 proposed regulations.

A reduction in the rate of allocation is directly because of a participant's attainment of any age for a plan year if under the terms of the plan, any participant’s rate of allocation during the plan year would be higher if the participant were younger.

A reduction in the rate of allocation is indirectly because of a participant's attainment of any age if any participant’s rate of allocation during the plan year would be higher if the participant were to have any characteristic which is a proxy for being younger, based on applicable facts and circumstances. A cessation or reduction in allocations is not indirectly because of the attainment of any age solely because of a positive correlation between attainment of any age and a reduction in the allocations or rate of allocation. Thus, a defined contribution plan does not provide for cessation or reduction in allocations solely because the plan limits the total amount of employer contributions and forfeitures that may be allocated to a participant's account or limits the total number of years of credited service that may be taken into account for purposes of determining allocations for the plan year.

Target benefit plans (defined contribution plans under which contributions are determined by reference to a targeted benefit described in the plan) are subject to section 411(b)(2) which applies to defined contribution plans. Under these proposed regulations, a target benefit plan would satisfy section 411(b)(2) only if the defined benefit formula used to determine allocations would satisfy section 411(b)(1)(H) without regard to section 411(b)(1)(H)(iii) relating to adjustments for distributions and actuarial increases. A target benefit plan would not fail to satisfy section 411(b)(2) with respect to allocations after normal retirement age merely because the allocation for a plan year is reduced to reflect an older participant’s shorter longevity using a reasonable actuarial assumption regarding mortality. These proposed regulations also would authorize the Commissioner to develop additional guidance with respect to the application of section 411(b)(2) to target benefit plans.

Optional Forms of Benefit and Other Rights and Features

These proposed regulations generally retain the requirements applicable to optional forms of benefit that were in the 1988 proposed regulations. Under these rules, with the exceptions noted below, a participant's rate of benefit accrual under a defined benefit plan and a participant's allocations under a defined contribution plan are considered to be reduced because of the participant's attainment of any age if optional forms of benefits, ancillary benefits, or other rights or features otherwise provided to a participant under the plan are not provided, or are provided on a less favorable basis, with respect to benefits or allocations attributable to credited service because of the participant's attainment of any age. In addition, a plan would not fail to satisfy section 411(b)(1)(H) merely due to variance because of the attainment of any age with respect to the subsidized portion of an early retirement benefit (whether provided on a temporary or permanent basis), a qualified disability benefit (as defined in §1.411(a)-7(c)(3)), or a social security supplement (as defined in §1.411(a)-7(c)(4)(ii)).[3] These proposed regulations also clarify that a plan would not fail to satisfy section 411(b)(1)(H) merely because the plan makes actuarial adjustments using a reasonable assumption regarding

[3]The ADEA also includes special rules relating to certain of these benefits. See 29 U.S.C. 623(f)(2) and (l).

mortality to calculate optional forms of benefit or to calculate the cost of providing a qualified preretirement survivor annuity, as defined in section 417(c).

Coordination With Other Provisions

Sections 411(b)(1)(H)(v) and 411(b)(2)(C) both provide for the coordination of the requirements of each section with other applicable qualification requirements. Under these proposed regulations, a plan will not fail to satisfy section 411(b)(1)(H) or 411(b)(2) because of a limit on accruals or allocations necessary to comply with the limitations of section 415 or to prevent discrimination in favor of highly compensated employees within the meaning of section 401(a)(4). Additionally, these proposed regulations would authorize the Commissioner to provide additional guidance relating to prohibited discrimination in favor of highly compensated employees. These proposed regulations would also provide that no benefit accrual or allocation is required under section 411(b)(1)(H) or 411(b)(2) for a plan year to the extent such allocation or accrual would cause the plan to fail to satisfy the requirements of section 401(l) (relating to permitted disparity) for the plan year, such as if a younger person has a smaller permitted disparity due to having a later social security retirement age. Further, under these proposed regulations, a plan would not fail to satisfy section 411(b)(1)(H) or 411(b)(2) for a plan year merely because of the distribution rights provided under section 411(a)(11), including deferral rights for participants whose benefits are immediately distributable within the meaning of §1.411(a)-11(c).

Application of Section 401(a)(4) to New Comparability Cash Balance Plans

These proposed regulations also include a proposed amendment to the regulations under section 401(a)(4). This amendment would provide that a defined benefit plan that determines compliance with section 411(b)(1)(H) by using the special definition of rate of accrual for an eligible cash balance plan is not permitted to demonstrate that the benefits provided under the arrangement do not discriminate in favor of highly compensated employees by using an inconsistent method (i.e., an accrual rate based on the normal retirement benefit), unless the plan complies with a modified version of the provisions of the regulations under section 401(a)(4) related to cross-testing by a defined contribution plan. Under these requirements, an eligible cash balance plan under which the additions to the hypothetical account are neither broadly available nor reflect a gradual age and service schedule, as defined under existing regulations relating to cross-tested defined contribution plans, may test on the basis of benefits only if the plan satisfies a minimum allocation gateway.

The minimum allocation gateway generally requires that the hypothetical allocation rate for each nonhighly compensated employee be at least one-third of the hypothetical allocation rate for the highly compensated employee with the highest hypothetical allocation rate. However, the minimum allocation gateway is also satisfied if the hypothetical allocation rate for each nonhighly compensated employee is no less than 5%, provided the highest hypothetical allocation rate for any highly compensated employee is not in excess of 25%. If the highest hypothetical allocation rate is above 25%, the 5% factor is increased, up to as much as 7.5%. This minimum allocation gateway, which is normally applicable to DB/DC plans (i.e., defined benefit plans and defined contribution plans that are combined for nondiscrimination testing), is used for purposes of eligible cash balance plans, rather than the minimum allocation gateway normally applicable to defined contribution plans, because hypothetical allocations under a cash balance plan can be significantly greater than allocations under a defined contribution plan.

If the eligible cash balance plan is aggregated with other plans that are not cash balance plans, the regulations would treat the cash balance plan as a defined contribution plan for purposes of applying the rules applicable to aggregated plans. For this purpose, a plan with both an eligible cash balance formula and a traditional defined benefit formula is treated as an aggregation of two plans.

Effective Date of Sections 411(b)(1)(H) and 411(b)(2)

The 1988 proposed regulations included provisions related to the effective date of sections 411(b)(1)(H) and 411(b)(2). The effective date provisions in these proposed regulations differ from the 1988 proposed regulations (and Notice 88-126) in order to reflect the decision in Lockheed Corp. v. Spink, 517 U.S. 882 (1996).

In general, sections 411(b)(1)(H) and 411(b)(2) are effective for plan years beginning on or after January 1, 1988 with respect to a participant who is credited with at least one hour of service in a plan year beginning on or after January 1, 1988. In the case of a participant who is credited with at least one hour of service in a plan year beginning on or after January 1, 1988, section 411(b)(1)(H) is effective with respect to all years of service completed by the participant, except that, in accordance with Lockheed Corp. v. Spink, plan years beginning before January 1, 1988 are excluded. For purposes of these proposed regulations, an hour of service includes any hour required to be recognized under the plan by section 410 or 411.

Similarly, section 411(b)(2) does not apply with respect to allocations of employer contributions or forfeitures to the accounts of participants under a defined contribution plan for a plan year beginning before January 1, 1988.

These proposed regulations would also provide a special effective date for a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers, ratified before March 1, 1986. For such plans, sections 411(b)(1)(H) and 411(b)(2) are effective for benefits provided under, and employees covered by, any such agreement with respect to plan years beginning on or after the later of (i) January 1, 1988 or (ii) the earlier of January 1, 1990 or the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension of any such agreement occurring on or after March 1, 1986). The otherwise generally applicable effective date rules would apply to a collectively bargained plan, as of the effective date of section 411(b)(1)(H) or 411(b)(2) applicable to such plan.

Proposed Effective Date

The regulations are proposed to be applicable to plan years beginning after the date final regulations are published in the **Federal Register**. These proposed regulations cannot be relied upon until adopted in final form. However, until these regulations are adopted in final form, the reliance provided on the 1988 proposed regulations continues to be available. In addition, the proposed regulations at §§1.410(a)-4A, 1.411(a)-3, 1.411(b)-3 and 1.411(c)-1(f)(2) (relating to maximum age for participation, vesting, normal retirement age, and actuarial adjustments after normal retirement age), which were published in the same notice of proposed rulemaking as the 1988 proposed regulation and which are not republished here, are also expected to be finalized for future plan years.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to written comments (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. Alternatively, taxpayers may submit comments electronically to the IRS Internet site at www.irs.gov/regs. All comments will be available for public inspection and copying. The IRS and Treasury request comments on the clarity of the proposed rules and how they may be made easier to understand or to implement. Comments are also requested on the following issues:

- Because these proposed regulations are based on a year-by-year determination of the rate of benefit accrual that does not accommodate averaging over a period of earlier years, one result would be that, if a higher accrual is provided for older workers in one year, the rates cannot be leveled out in subsequent periods in a manner that takes the earlier higher accruals into account. This might occur for a change from a fractional accrual method to a unit credit method for all years of service. Comments are requested on whether rates should be permitted to be averaged and, if so, under what conditions.
- In the case of a conversion of a traditional defined benefit plan to a cash balance plan, these proposed regulations generally provide for any excess of a participant's opening hypothetical account balance over the present value of the participant's prior accrued benefit to be tested for age discrimination. Comments are requested on whether any other portion of the hypothetical account balance should be disregarded in applying section 411(b)(1)(H) under other circumstances, for example, if the opening account balance is a reconstructed cash balance account (i.e., the account balance that each participant would have had at the time of the conversion if the cash balance formula had been in effect for the participant's entire period of service). In addition, comments are requested on the effect of these rules on employers, if any, that may have used the extended wear-away transition rule of §1.401(a)(4)-13(f)(2)(i).
- Because these proposed regulations provide for the rate of benefit accrual under section 411(b)(1)(H) to be based on the annual increase in the accrued benefit

under the plan, the rate of benefit accrual under a floor offset plan, as described in Rev. Rul. 76-259 (1976-2 CB 111), would be determined after taking into account the amount of the offset. Comments are requested on whether the rate of benefit accrual for a floor offset plan should be tested before application of the offset and, if so, under what conditions. For example, should the rate of benefit accrual for a floor offset plan be tested before application of the offset if the plan provides an actuarial increase after normal retirement age or if the annuity purchase rate used to calculate the offset is not less favorable after normal retirement age than the annuity purchase rate applicable at normal retirement age.

A public hearing has been scheduled for April 10, 2003, at 10 a.m. in room 4718 of the Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC. All visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts at the Constitution Avenue entrance. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by March 13, 2003. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these proposed regulations are Linda S. F. Marshall and R. Lisa Mojiri-Azad of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR Part 1 is proposed to be amended as follows:

PART 1 -- INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding the following citation in numerical order:

Authority: 26 U.S.C. 7805 * * *

Section 1.411(b)-2 is also issued under 26 U.S.C. 411(b)(1)(H) and 411(b)(2). * * *

Par. 2. Section 1.401(a)(4)-3 is amended as follows:

1. A new sentence is added before the last sentence of paragraph (a)(1).

2. Paragraph (g) is added.

The additions and revisions read as follows:

<u>§1.401(a)(4)-3 Nondiscrimination in amount of employer-provided benefits under a defined benefit plan.</u>

(a) Introduction--(1) Overview. * * * Paragraph (g) of this section provides additional rules that apply to a plan that satisfies the requirements of section 411(b)(1)(H) and §1.411(b)-2 using the rate of benefit accrual determined pursuant to the rules of §1.411(b)-2(b)(2)(iii) for eligible cash balance plans. * * *

* * * * *

(g) Additional rules for eligible cash balance plans--(1) In general. Notwithstanding the provisions of paragraphs (a) through (f) of this section, a plan that satisfies the requirements of section 411(b)(1)(H) and §1.411(b)-2 using the rate of benefit accrual under the plan or a portion of the plan determined pursuant to the rules of §1.411(b)-2(b)(2)(iii) for eligible cash balance plans is permitted to satisfy the requirements of section 401(a)(4) by satisfying the requirements of this section (relating to nondiscrimination in amount of employer-provided benefits) only if the plan satisfies paragraph (g)(2) or (3) of this section, as applicable.

(2) Eligible cash balance plans not aggregated with another defined benefit plan. A plan described in paragraph (g)(1) of this section under which benefits are determined solely in accordance with an eligible cash balance formula (as defined in §1.411(b)-2(b)(2)(iii)(C)(1)) satisfies this paragraph (g)(2) only if the plan meets either of the following conditions--

(i) The plan would satisfy the requirements of §1.401(a)(4)-8(b)(1)(iii) or (iv) by treating the additions to the hypothetical account that are included in the rate of benefit accrual under the rules of §1.411(b)-2(b)(2)(iii)(A) as allocations under a defined contribution plan; or

(ii) The plan would satisfy the requirements of §1.401(a)(4)-9(b)(2)(v)(D) by treating the additions to the hypothetical account that are included in the rate of benefit accrual under the rules of §1.411(b)-2(b)(2)(iii)(A) as allocations under a defined contribution plan for purposes of determining equivalent normal allocation rates (within the meaning of §1.401(a)(4)-9(b)(2)(ii)).

(3) Eligible cash balance plans aggregated with another defined benefit plan. In the case of a plan described in paragraph (g)(1) of this section that is not described in paragraph (g)(2) of this section (for example, an eligible cash balance plan that is aggregated with another defined benefit plan that is not an eligible cash balance plan or a plan that uses an eligible cash balance formula with a traditional defined benefit plan formula as described in §1.411(b)-2(b)(2)(iii)(C)), the plan would satisfy the requirements of §1.401(a)(4)-9(b)(2)(v)(D) by treating the additions to the hypothetical account that are included in the rate of benefit accrual under the rules of §1.411(b)-2(b)(2)(iii)(A) as allocations under a defined contribution plan.

Par. 3. Section 1.401(a)(4)-9 is amended by:

1. Amending paragraph (b)(2)(v) by removing the language "For plan years" and adding in its place "Except as provided in paragraph (b)(2)(vi) of this section, for plan years".

2. Adding paragraph (b)(2)(vi).

The addition reads as follows:

§1.401(a)(4)-9 Plan aggregation and restructuring

* * * * *

(b) * * *

(2) * * *

(vi) Special rules for cash balance plans aggregated with defined contribution plans--(A) In general. In the case of a DB/DC plan where the defined benefit plan (or any portion thereof) satisfies the requirements of section 411(b)(1)(H) using the rate of benefit accrual determined pursuant to the rules of §1.411(b)-2(b)(iii) for eligible cash balance plans, the DB/DC plan is permitted to demonstrate satisfaction of the nondiscrimination in amount requirement of §1.401(a)(4)-1(b)(2) on the basis of benefits only if--

(1) The plan would satisfy the requirements of paragraph (b)(2)(v) of this section if the additions to the hypothetical account that are included in the rate of benefit accrual under the rules of §1.411(b)-2(b)(2)(iii)(A) are treated as allocations under a defined contribution plan; or

(2) The plan is described in paragraph (b)(2)(vi)(B) of this section (regarding eligible cash balance plans aggregated only with defined contribution plans).

(B) Special rule for cash balance plans aggregated with defined contribution plans that are not aggregated with other defined benefit plans. A DB/DC plan is described in this paragraph (b)(2)(vi)(B) if the DB/DC plan satisfies the following conditions--

(1) All defined benefit plans that are included in the DB/DC plan satisfy the requirements of section 411(b)(1)(H) using the rate of benefit accrual determined pursuant to the rules of §1.411(b)-2(b)(iii) for eligible cash balance plans; and

(2) The DB/DC plan would satisfy the requirements of §1.401(a)(4)-8(b)(1)(i)(B)(1) or (2) (regarding broadly available allocation rates or certain age-based allocation rates) if

the additions to the hypothetical account that are included in the rate of benefit accrual under the rules of §1.411(b)-2(b)(2)(iii)(A) are treated as allocations under a defined contribution plan.

Par. 4. Proposed §1.411(b)-2 published at 53 FR 11876 on April 11, 1988, is revised to read as follows.

§1.411(b)-2 Reductions of accruals or allocations because of attainment of any age.

(a) In general--(1) Overview. Section 411(b)(1)(H) provides that a defined benefit plan does not satisfy the minimum vesting standards of section 411(a) if, under the plan, benefit accruals on behalf of a participant are ceased or the rate of benefit accrual on behalf of a participant is reduced because of the participant's attainment of any age. Section 411(b)(2) provides that a defined contribution plan does not satisfy the minimum vesting standards of section 411(a) if, under the plan, allocations to a participant's account are ceased or the rate of allocation to a participant's account is reduced because of the participant's attainment of any age. Paragraph (b) of this section provides general rules for defined benefit plans. Paragraph (c) of this section provides general rules for defined contribution plans. Paragraph (d) of this section provides rules applying this section to optional forms of benefit, ancillary benefits, and other rights or features under defined benefit and defined contribution plans. Paragraph (e) of this section provides rules coordinating the requirements of this section with certain other qualification requirements. Paragraph (f) of this section contains effective date provisions.

(2) Attainment of any age. For purposes of sections 411(b)(1)(H), 411(b)(2), and this section, a participant’s attainment of any age means the participant’s growing older.

Thus, the rules of sections 411(b)(1)(H), 411(b)(2), and this section apply regardless of whether a participant is younger than, at, or older than normal retirement age.

(b) Defined benefit plans--(1) In general--(i) Requirement. A defined benefit plan does not satisfy the requirements of section 411(b)(1)(H) if a participant's rate of benefit accrual is reduced, either directly or indirectly, because of the participant's attainment of any age. A reduction in a participant's rate of benefit accrual includes any discontinuance in the participant's accrual of benefits or cessation of participation in the plan.

(ii) Definition of normal form. For purposes of this paragraph (b), the normal form of benefit (also referred to as the normal form) means the form under which payments to the participant under the plan are expressed under the plan formula, prior to adjustment for form of benefit.

(2) Rate of benefit accrual--(i) Rate of benefit accrual before normal retirement age. For purposes of this paragraph (b), except as provided in paragraph (b)(2)(iii) of this section, a participant's rate of benefit accrual for any plan year that ends before the participant attains normal retirement age is the excess (if any) of--

(A) The participant's accrued normal retirement benefit at the end of the plan year; over

(B) The participant's accrued normal retirement benefit at the end of the preceding plan year.

(ii) Rate of benefit accrual after normal retirement age. In the case of a plan for which the rate of benefit accrual before normal retirement age is determined under paragraph (b)(2)(i) of this section, except as provided in paragraph (b)(4)(iii)(C) of this section, a participant's rate of benefit accrual for the plan year in which the participant attains normal retirement age or any later plan year (taking into account the provisions of section 411(b)(1)(H)(iii)(II)) is the excess (if any) of--

(A) The annual benefit to which the participant is entitled at the end of the plan year, determined as if payment commences at the end of the plan year in the normal form (or the straight life annuity that is actuarially equivalent to the normal form if the normal form is not an annual benefit that does not decrease during the lifetime of the participant); over

(B) The annual benefit to which the participant was entitled at the end of the preceding plan year, determined as if payment commences at the later of normal retirement age or the end of the preceding plan year in the normal form (or the straight life annuity that is actuarially equivalent to the normal form if the normal form is not an annual benefit that does not decrease during the lifetime of the participant).

(iii) Rate of benefit accrual for eligible cash balance plans--(A) General rule. For purposes of this paragraph (b), in the case of an eligible cash balance plan, a participant's rate of benefit accrual for a plan year is permitted to be determined as the addition to the participant's hypothetical account for the plan year, except that interest credits added to the hypothetical account for the plan year are disregarded to the extent the participant had accrued the right to those interest credits as of the close of the preceding plan year as described in paragraph (b)(2)(iii)(B)(2) of this section.

(B) Eligible cash balance plans. For purposes of this section, a defined benefit plan is an eligible cash balance plan for a plan year if it satisfies each of the following requirements for current accruals under the plan for that plan year--

(1) Plan design. The normal form of benefit is an immediate payment of the balance in a hypothetical account (without regard to whether such an immediate payment is actually available under the plan).

(2) Right to future interest. With respect to a participant's hypothetical account balance, the participant has accrued the right to annual (or more frequent) interest credits to be added to the hypothetical account for all future periods without regard to future service at a reasonable rate of interest that is not reduced, either directly or indirectly, because of the participant's attainment of any age. A plan is treated as not satisfying the requirement of this paragraph (b)(2)(iii)(B)(2) if it provides for any adjustment for benefit distributions described in paragraph (b)(4) of this section.

(3) Plan amendments adopting cash balance formula. In the case of a plan amendment that has been amended to adopt a cash balance formula (as described in paragraphs (b)(2)(iii)(B)(1) and (2) of this section) for a participant, the plan as amended satisfies the requirements of either paragraph (b)(2)(iii)(D) or (E) of this section.

(C) Plans with mixed benefit formulas--(1) Eligible cash balance formula. If a portion of the plan formula under a defined benefit plan would satisfy the requirements to be an eligible cash balance plan if it were the only formula under the plan, then, for purposes of this section, such portion of the plan formula is referred to as an eligible cash balance formula and the other portion of the plan formula is referred to as a traditional defined benefit formula. If the eligible cash balance formula and the traditional defined benefit formula interact in a manner described in paragraph (b)(2)(iii)(C)(2), (3), or (4) of this section for current and future accruals under the plan, then, for purposes of determining whether the plan satisfies section 411(b)(1)(H), the plan is permitted to be treated as two separate plans, one of which is an eligible cash balance plan and the other of which is not, but only if each such plan would satisfy section 410(a)(2). Thus, such a plan satisfies the requirements of section 411(b)(1)(H) if the eligible cash balance formula satisfies the requirements of paragraph (b)(1) of this section with the participant's rate of benefit accrual determined under paragraph (b)(2)(iii)(A) of this section and the portion of the plan's formula that is a traditional defined benefit formula satisfies the requirements of paragraph (b)(1) of this section with the participant's rate of benefit accrual determined under paragraph (b)(2)(i) or (ii) of this section, as applicable. If the eligible cash balance formula and the traditional defined benefit formula interact in a manner other than as set forth in paragraphs (b)(2)(iii)(C)(2), (3), or (4) of this section, the plan is not treated as an eligible cash balance plan for any portion of the plan formula.

(2) Plans with additive formulas. A plan is described in this paragraph (b)(2)(iii)(C)(2) if the participant's benefit is based on the sum of accruals under two different formulas, one of which is an eligible cash balance formula and the other of which is not.

(3) Plans with greater of formulas. A plan is described in this paragraph (b)(2)(iii)(C)(3) if the plan provides a benefit for a participant equal to the greater of the benefit determined under two or more formulas under the plan for a plan year, one of which is an eligible cash balance formula and another of which is not.

(4) Different formulas for different participants. A plan is described in this paragraph (b)(2)(iii)(C)(4) if some participants are eligible for accruals only under an

eligible cash balance formula and the remaining participants are eligible for accruals only under a traditional defined benefit formula or a combination of a traditional defined benefit formula or eligible cash balance formula described in paragraphs (b)(2)(iii)(C)(2) and (3) of this section.

(D) Plan amendment adopting eligible cash balance formula using a sum of formula. A plan satisfies this paragraph (b)(2)(iii)(D) only if for all periods after the amendment becomes effective the plan provides benefits that are not less than the sum of the benefits accrued as of the later of the date the amendment becomes effective or the date the amendment is adopted, plus the benefits provided by the participant's hypothetical account under the eligible cash balance formula.

(E) Plan amendment adopting eligible cash balance formula using an opening account balance--(1) Calculation of opening account balance. A plan satisfies this paragraph (b)(2)(iii)(E) only if the balance in the participant's hypothetical account, determined immediately after the amendment becomes effective, is not less than the actuarial present value of the participant's accrued benefit payable in the normal form of benefit, determined as of the later of the date the amendment becomes effective or the date the amendment is adopted, with such present value determined using reasonable actuarial assumptions. For this purpose, the actuarial assumptions are not reasonable if they include an interest rate that increases, either directly or indirectly, because of a participant's attainment of any age. The actuarial assumptions do not fail to be reasonable merely because pre-retirement mortality is not taken into account.

(2) Bifurcation for purposes of determining rate of benefit accrual. If a plan satisfies the requirements of paragraph (b)(2)(iii)(E)(1), only the portion of the participant's hypothetical account balance in excess of the actuarial present value of the participant's accrued benefit payable in the normal form of benefit is treated as an addition to the participant's hypothetical account balance for the plan year for purposes of determining the participant's rate of benefit accrual under paragraph (b)(2)(iii)(A) of this section.

(3) Treatment of employees past normal retirement age. In addition, a plan does not satisfy this paragraph (b)(2)(iii)(E) if the opening balance for a participant who has attained normal retirement age is less than the balance that would apply if the participant were at his or her normal retirement age.

(iv) Determination of rate of benefit accrual--(A) In general. A participant's rate of benefit accrual for a plan year can be determined as a dollar amount. Alternatively, if a plan's formula bases a participant's accruals on current compensation, then a participant's rate of benefit accrual can be determined as a percentage of the participant's current compensation. For example, for an accumulation plan (as defined in §1.401(a)(4)-12), the participant's rate of benefit accrual under paragraph (b)(2)(i) of this section can be determined as the excess of the accrued portion of the participant's normal retirement benefit at the end of the plan year over the accrued portion of the participant's normal retirement benefit at the end of the preceding plan year, divided by compensation taken into account under the plan for the plan year. Likewise, if a plan's formula bases a participant's accruals on average compensation, then a participant's rate of benefit accrual can be determined as a percentage of that measure of the participant's average compensation. For a plan that determines benefits as a percentage of average annual compensation (as defined in §1.401(a)(4)-3(e)(2)), the rate of benefit accrual under paragraph (b)(2)(i) of this section is determined as the excess of the accrued portion of the participant's normal retirement benefit at the end of the plan year divided by average annual compensation taken into account under the plan at the end of the plan year, over the accrued portion of the participant's normal retirement benefit at the end of the preceding plan year divided by average annual compensation taken into account under the plan at the end of such preceding plan year. A plan is permitted to determine the participant's rate of benefit accrual as a percentage of the participant's current or average compensation only if compensation under the plan is determined without regard to attainment of any age.

(B) Benefits included in rate of benefit accrual. For purposes of determining a participant's rate of benefit accrual, only benefits that are included in a participant's accrued benefit are taken into account. Thus, for example, a participant's rate of benefit accrual does not take into account benefits such as the benefits described in paragraph (d)(3) of this section (relating to qualified disability benefits, social security supplements, and early retirement benefits).

(v) Examples. The following examples illustrate the application of this paragraph (b)(2). In each of the examples, normal retirement age is 65. The examples are as follows:

Example 1. Plan L is a defined benefit plan under which the normal form of benefit is a monthly straight life annuity commencing at normal retirement age (or the date of actual retirement, if later) equal to $30 times the participant's years of service. For purposes of this section, a participant's rate of benefit accrual for any plan year is $30.

Example 2. (i) Plan M is a defined benefit plan under which the normal form of benefit is an annual straight life annuity commencing at normal retirement age (or the date of actual retirement, if later) equal to 1% of the average of a participant's highest 3 consecutive years of compensation times the participant's years of service.

(ii) For purposes of this section, a participant's rate of benefit accrual for any plan year can be expressed as a dollar amount. Alternatively, a participant's rate of benefit accrual for a plan year can be expressed as 1% of the participant's highest 3 consecutive years of compensation (determined using the same rules applicable to determining compensation under the plan for purposes of computing the normal form of benefit), provided that the definition of compensation used for this purpose is determined without regard to the attainment of any age. A participant's rate of benefit accrual cannot be determined as a percentage of any other measure of compensation or average compensation.

(iii) If Plan M were to provide that compensation earned after the attainment of age 65 is not taken into account in determining average compensation or were otherwise to determine compensation in a manner that depends on a participant's age, then, for purposes of this section, a participant's rate of benefit accrual would have to be expressed as a dollar amount, and could not be expressed as a percentage of any measure of compensation or average compensation.

Example 3. (i) Plan N is a defined benefit plan under which the normal form of benefit is an immediate payment of the balance in a participant's hypothetical account. A compensation credit equal to 6% of each participant's wages for the year is added to the hypothetical account of a participant who is an employee. At the end of each plan year, the hypothetical account is credited with interest based on the applicable interest rate under section 417(e), as provided under the plan. All participants accrue the right to receive interest credits on their hypothetical account in the future regardless of performance of services in the future, including after normal retirement age.

(ii) Under paragraph (b)(2)(iii)(B) of this section, Plan N satisfies the requirements to be an eligible cash balance plan. Participant A's compensation for a plan year is $40,000. The compensation credit for Participant A allocated to A's hypothetical account for that plan year is $2,400. Because Plan N is an eligible cash balance plan, the rate of benefit accrual for Participant A is permitted to be determined as the addition to Participant A's hypothetical account for the plan year, disregarding interest credits. Therefore, Participant A's rate of benefit accrual is equal to $2,400, or 6% of wages.

Example 4. (i) The facts are the same as in Example 3, except that the cash balance formula under Plan N is the result of a plan amendment. Under the plan, as amended, the benefits equal the sum of --

(1) 1% of the average of the participant's highest 3 consecutive years of base salary times years of service, but disregarding service and salary after the effective date of the amendment, in a normal form of benefit that is a straight life annuity commencing at normal retirement age (or the date of actual retirement, if later); and

(2) the participant's hypothetical account under the same cash balance formula in Example 3 that applies after the effective date of the amendment, in a normal form of benefit expressed as an immediate payment of the balance of the participant's hypothetical account.

(ii) Under paragraph (b)(2)(iii)(B)(3) of this section, the plan is an eligible cash balance plan if the plan satisfies the requirements of paragraph (b)(2)(iii)(D) or (E) of this section. The plan's formula is described in paragraph (b)(2)(iii)(D) of this section. Accordingly, the portion of the plan formula that provides for compensation credits on a participant's hypothetical account is an eligible cash balance formula under paragraph (b)(2)(iii)(B) of this section. Therefore, a participant's rate of benefit accrual under the eligible cash balance formula is permitted to be determined as the addition to the participant's hypothetical account for the plan year, disregarding interest credits. Participant B's base salary for the year is $50,000. The compensation credit for Participant B credited to B's hypothetical account for the year is $3,000. The rate of benefit accrual under the eligible cash balance formula for Participant B is equal to $3,000, or 6% of base salary.

Example 5. (i) The facts are the same as in Example 3, except that Plan N is a defined benefit plan that is converted to a cash balance plan by the adoption of a plan amendment, effective at the beginning of the next plan year, establishing an opening hypothetical account for each participant with an accrued benefit under the plan prior to conversion. Prior to conversion, Plan N provided a benefit equal to 1% of the average of a participant's highest 3 consecutive years of compensation times years of service. Effective as of the date of the conversion, hypothetical accounts are established equal to the present value of a participant's accrued benefit using section 417(e) interest and reasonable mortality assumptions (except no pre-retirement mortality is used). Under the cash balance portion of the formula, compensation and interest credits are made as described in Example 3.

(ii) Under paragraph (b)(2)(iii)(B)(3) of this section, the plan is an eligible cash balance plan only if the plan satisfies the requirements of paragraph (b)(2)(iii)(D) or (E) of this section. The plan's formula is described in paragraph (b)(2)(iii)(E) of this section. Accordingly, the portion of the plan formula that provides for compensation credits on a participant's hypothetical account is an eligible cash balance formula. The rate of benefit accrual for a participant is therefore permitted to be determined as the addition to the participant's hypothetical account for the plan year, disregarding interest credits. In addition, under paragraph (b)(2)(iii)(E) of this section, because the opening hypothetical account balance is equal to the actuarial present value of the participant's accrued benefit, that balance is not treated as an addition for the plan year. The result would not be different if the opening accounts were established using another interest rate or another mortality assumption if the actuarial assumptions were reasonable. Participant C's wages for the year are $60,000. The compensation credit allocated to C's hypothetical account for the year is $3,600. The rate of accrual under the eligible cash balance formula for C is equal to $3,600, or 6% of compensation.

Example 6. (i) The facts are the same as in Example 5, except that Plan N provides for only new participants and participants who are less than age 55 at the time of the conversion to be eligible for benefits under the cash balance formula. Accordingly, participants who are age 55 or older at the time of the conversion are only eligible for the benefit payable under the plan formula in effect before the conversion (1% of the participant's highest 3 consecutive years of compensation times years of service) taking into account compensation and service after the conversion.

(ii) Because Plan N provides benefits based on a mixed formula under paragraph (b)(2)(iii)(C) of this section, Plan N is permitted under paragraph (b)(2)(iii)(C)(1) of this section to be treated as two separate plans for purposes of section 411(b)(1)(H), one of which is an eligible cash balance plan and the other of which is not, but only if each plan would satisfy section 410(a)(2). No portion of Plan N can be treated as an eligible cash balance plan because the portion of Plan N that would otherwise be an eligible cash balance plan would fail to satisfy section 410(a)(2) as a result of having a maximum age of 55 for individuals who are participants at the time of the conversion.

Example 7. (i) The facts are the same as in Example 5, except that Plan N provides for participants to receive the greater of the benefit payable under the cash balance formula or the benefit payable under the plan formula in effect before the conversion (1% of the participant's highest 3 consecutive years of compensation times years of service) taking into account compensation and service after the conversion.

(ii) Because Plan N provides benefits based on the greater of the amount payable under two different formulas, under paragraph (b)(2)(iii)(C)(4) of this section, Plan N is tested for satisfaction of the requirements of section 411(b)(1)(H) and this paragraph (b) by separately testing the eligible cash balance formula using a rate of benefit accrual equal to compensation credits of 6% of compensation and the traditional defined benefit formulas using a rate of benefit accrual equal to 1% of highest 3 consecutive years of compensation.

(3) Reduction that is directly or indirectly because of a participant's attainment of any age--(i) Reduction in rate of benefit accrual that is directly because of a participant's

attainment of any age. A plan provides for a reduction in the rate of benefit accrual that is directly because of a participant's attainment of any age for any plan year if, under the terms of the plan, any participant's rate of benefit accrual for the plan year would be higher if the participant were younger. Thus, a plan fails to satisfy section 411(b)(1)(H) and this paragraph (b) if, under the terms of the plan, the rate of benefit accrual for any individual who is or could be a participant under the plan would be lower solely as a result of the individual being older.

(ii) Reduction in rate of benefit accrual that is indirectly because of a participant's attainment of any age--(A) In general. A plan provides for a reduction in the rate of benefit accrual that is indirectly because of a participant's attainment of any age for any plan year if any participant's rate of benefit accrual for the plan year would be higher if the participant were to have a different characteristic which is a proxy for being younger, based on the all of relevant facts and circumstances. Thus, a plan fails to satisfy section 411(b)(1)(H) and this paragraph (b) if the rate of benefit accrual for any individual who is or could be a participant under the plan would be lower solely as a result of such individual having a different characteristic which is a proxy for being older, based on all of the relevant facts and circumstances.

(B) Permissible limitations. A reduction in a participant's rate of benefit accrual is not indirectly because of the attainment of any age in violation of section 411(b)(1)(H) solely because of a positive correlation between attainment of any age and a reduction in the rate of benefit accrual. In addition, a defined benefit plan does not fail to satisfy section 411(b)(1)(H) and this paragraph (b) solely because, on a uniform and consistent basis without regard to a participant's age, the plan limits the amount of benefits a participant may accrue under the plan, limits the number of years of service or years of participation taken into account for purposes of determining the accrual of benefits under the plan (credited service), or provides for a reduced rate of accrual for credited service in excess of a fixed number of years. For this purpose, a limitation that is expressed as a percentage of compensation (whether averaged over a participant's total years of credited service for the employer or over a shorter period) is treated as a permissible limitation on the amount of benefits a participant may accrue under the plan.

(iii) Examples. The provisions of this paragraph (b)(3) may be illustrated by the following examples. In each of the examples, except as specifically indicated, normal retirement age is 65, the plan contains no limitations on the maximum amount of benefits the plan will pay to any participant (other than the limitations imposed by section 415), on the maximum number of years of credited service taken into account under the plan, or on the compensation used for purposes of determining the amount of any participant's accrued benefit (other than the limitation imposed by section 401(a)(17)), and the plan uses the following actuarial assumptions in determining actuarial equivalence: a 7.5% rate of interest and the 83 GAM (male) mortality table. The examples are as follows:

Example 1. (i) Plan M provides an accrued benefit of 1% of a participant's average annual compensation, multiplied by the participant's years of credited service under the plan payable in the normal form of a straight life annuity commencing at normal retirement age or the date of actual retirement if later. Plan M suspends payment of benefits for participants who work past normal retirement age, in accordance with section 411(a)(3)(B) and 29 CFR 2530.203-3 of the regulations of the Department of Labor, and does not provide for an actuarial increase in computing the accrued benefit for participants who commence benefits after normal retirement age.

(ii) The rate of benefit accrual for all participants in Plan M is 1% of average annual compensation. Thus, there could be no participant who would have a rate of benefit accrual that is greater than 1% if the individual were younger. Accordingly, there is no reduction in the rate of benefit accrual because of the individual's attainment of any age under this paragraph (b)(3) and Plan M satisfies the requirements of section 411(b)(1)(H) and this paragraph (b).

Example 2. (i) Assume the same facts as in Example 1, except that Plan M provides that not more than 35 years of credited service are taken into account in determining a participant's accrued benefit under the plan. Participant A became a participant in the plan at age 25 and worked continuously in covered service under Plan M until A retires at age 70.

(ii) The rate of benefit accrual under Plan M is 1% of average annual compensation for participants who have up to 35 years of credited service and zero for participants who have more than 35 years of credited service. Because a reduction from a rate of benefit accrual from 1% of average annual compensation to zero is based on service, and would not be affected if any participant were younger (with the same number of years of service), Plan M does not provide for a reduction in the rate of benefit accrual that is directly because of an individual's attainment of any age as provided in paragraph (b)(3)(i) of this section. Under paragraph (b)(3)(ii) of this section, a uniform limit on the number of years of service taken into account for purposes of determining the accrual of benefits under the plan is not considered to be a reduction in the rate of benefit accrual that is indirectly because of a participant's attainment of any age.

(iii) Upon A's retirement at age 70, A will have an accrued benefit under the plan's benefit formula of 35% of A's average annual compensation at age 70 (1% per year of credited service x 35 years of credited service). Plan M will not fail to satisfy the requirements of section 411(b)(1)(H) and this paragraph (b) merely because the plan provides that the final 10 years of A's service under the plan are not taken into account in determining A's accrued benefit. The result would be the same if Plan M provided that no participant could accrue a benefit in excess of 35% of the participant's average annual compensation.

Example 3. Assume the same facts as in Example 1, except that Plan M provides that a participant's years of service after attainment of social security retirement age are disregarded for purposes of determining a participant's accrued benefit under the plan. Because a participant who is covered under the plan after social security retirement age would have a higher rate of benefit accrual if he or she were younger (and had not attained social security retirement age), that participant's rate of benefit accrual is reduced directly because of the participant's attainment of any age under paragraph (b)(3)(i) of this section. Consequently, Plan M fails to satisfy the requirements of section 411(b)(1)(H) and this paragraph (b).

Example 4. (i) Assume the same facts as in Example 1, except that Plan M provides that a participant's compensation after the attainment of age 62 is not taken into account in determining the participant's accrued benefit under the plan.

(ii) Accordingly, the plan’s measure of average compensation cannot be used in determining a participant’s rate of benefit accrual because it does not apply to participants in a uniform manner that is independent of age. Because a participant who is or could be covered under Plan M after the attainment of age 62 whose compensation increases after age 62 would have a higher rate of benefit accrual if the participant were younger than age 62, that participant’s rate of benefit accrual is reduced directly because of the participant’s attainment of any age under paragraph (b)(3)(i) of this section. This reduction occurs whether or not there is any actual participant in Plan M who has attained age 62 or whose average annual compensation has increased after age 62. Consequently, the plan fails to satisfy the requirements of section 411(b)(1)(H) and this paragraph (b).

Example 5. (i) Assume the same facts as in Example 1, except that Plan M is amended to cease all benefit accruals for all participants and is subsequently terminated.

(ii) After all benefit accruals have ceased, the rate of benefit accrual of all participants is zero. Thus, there could not be any participant who would have a rate of benefit accrual that is greater than zero if the participant were younger, so that there is no reduction in the rate of benefit accrual that is because of the individual’s attainment of any age under paragraph (b)(3) of this section. Accordingly, Plan M satisfies the requirements of section 411(b)(1)(H) and this paragraph (b).

Example 6. (i) Employer Y maintains Plan O, a defined benefit plan that provides an accrued benefit of 1% of a participant’s highest 5 consecutive years of compensation, multiplied by the sum of the participant’s age and years of service, payable in the normal form of a straight life annuity commencing at normal retirement age or the date of actual retirement if later. Plan O provides that a participant’s years of service after the sum of a participant’s age and years of service reach a total of 55 are disregarded for purposes of determining the normal retirement benefit. Participant C is 45 years old and has 10 years of credited service as of the beginning of a plan year. Thus, for that plan year, C’s rate of benefit accrual is 1% of C’s highest 5 consecutive years of compensation.

(ii) If C were younger, for example age 39 (with the same years of service), C would have a rate of benefit accrual of 2% of C’s highest 5 consecutive years of compensation. Accordingly, C’s rate of benefit accrual is reduced directly because of C’s attainment of any age as provided in this paragraph (b)(3)(i). Consequently, Plan O fails to satisfy the requirements of section 411(b)(1)(H) and this paragraph (b).

Example 7. (i) Plan P is a defined benefit plan that provides for a normal retirement benefit of 40% of a participant’s average compensation for the participant’s highest 3 consecutive years of compensation, payable in the normal form of a straight life annuity commencing at normal retirement age or the date of actual retirement if later. If a participant separates from service prior to normal retirement age, Plan P provides a benefit equal to an amount that bears the same ratio to 40% of such average compensation as the participant's actual number of years of service bears to the number of years of service the participant would have if the participant's service continued to normal retirement age. As of the end of a plan year, participant D is 45 years old and has completed 20 years of service, and participant E is 41 years old and has completed 1 year of credited service. Thus, D's rate of benefit accrual for the plan year may be determined as 1% of compensation for D's highest 3 consecutive years, and E's rate of benefit accrual for the plan year may be determined as 1.6% of compensation for E's highest 3 consecutive years.

(ii) If D were younger than age 45 (with 20 years of service and the same compensation history), D's rate of benefit accrual for the plan year would not be greater than 1% of compensation for D's highest 3 consecutive years. Thus, there is no reduction in the rate of benefit accrual for D that is directly because of the individual's attainment of any age as provided in paragraph (b)(3)(i) of this section. In addition, there are no facts and circumstances indicating that D's rate of benefit accrual is reduced indirectly because of D's attainment of any age as provided in paragraph (b)(3)(ii) of this section. Likewise, if E were younger than age 41 (with 1 year of service and the same compensation history), E's rate of benefit accrual for the plan year would not be greater than 1.6% of compensation for E's highest 3 consecutive years. Thus, there is no reduction in the rate of benefit accrual for E that is directly because of the individual's attainment of any age as provided in paragraph (b)(3)(i) of this section. In addition, there are no facts and circumstances indicating that E's rate of benefit accrual is reduced indirectly because of E's attainment of any age under paragraph (b)(3)(ii) of this section. These same results would apply for any possible participant in Plan P. Accordingly, Plan P satisfies the requirements of section 411(b)(1)(H) and this paragraph (b).

<u>Example 8</u>. (i) Plan A is a defined benefit plan that provides for an accrued benefit of 2% of a participant's average compensation for the participant's highest 3 consecutive years of compensation for the first 20 years of service, plus 1% of such average compensation for years in excess of 20, payable in the normal form of a straight life annuity commencing at normal retirement age or the date of actual retirement if later. However, if a participant separates from service prior to normal retirement age, Plan P provides a benefit equal to an amount that bears the same ratio to the total percentage of such average compensation that the participant would have if service continued to normal retirement age as the participant's actual number of years of service bears to the number of years of service the participant would have if the participant's service continued to normal retirement age. For participants who work past normal retirement age, Plan A provides a benefit equal to 2% per year for years of service not in excess of 20, plus the following rate for years of service in excess of 20: the sum of 40% plus the product of 1%

times service in excess of 20 years, with that sum divided by total service to the end of the current plan year. As of the beginning of the plan year beginning January 1, 2008, participant N is 64 years old and has completed 20 years of service, and participant O is 70 years old and has completed 20 years of credited service. Thus, N's rate of benefit accrual for that plan year may be determined as 1.95% of compensation for N's highest 3 consecutive years (2% for 20 years, plus 1% for 1 year, with that sum divided by 21 equals 1.95%), and O's rate of benefit accrual for that plan year also may be determined 1.95% of compensation for O's highest 3 consecutive years (40% for the first 20 years, plus 1% for service to the end of 2008, with that sum divided by 21 equals 1.95%).

(ii) If O were younger than age 70 (with 20 years of service and the same compensation history), O's rate of benefit accrual for the plan year would not be greater than 1.95% of compensation for O's highest 3 consecutive years. The same conclusion applies for any other possible participant. Thus, Plan A satisfies paragraph (b)(3)(ii) of this section.

(iii) However, if Plan A were instead to provide a rate of benefit accrual for service after normal retirement age equal to 2% for years of service not in excess of 20, plus 1% for service in excess of 20, Plan A would fail to satisfy paragraph (b)(3)(ii) of this section. For example, O's rate of benefit accrual would be 1% for 2008, whereas N's rate of benefit accrual would be 1.95% for 2008, even though the only difference between O and N is that N is younger.

<u>Example 9</u>. (i) The facts are similar to <u>Example 8</u>, except that the formula is 1% of a participant's average compensation for the participant's highest 3 consecutive years of compensation for the first 20 years, plus 2% of such average compensation for years in excess of 20, payable in the normal form of a straight life annuity commencing at normal retirement age or the date of actual retirement if later. As in <u>Example 8</u>, if a participant separates from service prior to normal retirement age, Plan P provides a benefit equal to an amount that bears the same ratio to the total percentage of such average compensation that the participant would have if service continued to normal retirement age as the participant's actual number of years of service bears to the number of years of service the participant would have if the participant's service continued to normal retirement age. Further, similar to the facts in <u>Example 8</u>(iii) of this paragraph (b)(3)(iii), for participants who work past normal retirement age, Plan A provides a benefit equal to 1% per year for years of service not in excess of 20, plus 2% per year for years of service in excess of 20. As of the beginning of the plan year beginning January 1, 2008, participant K is 45 years old and has completed 10 years of service, and participant M is 55 years old and has completed 10 years of credited service. Thus, K's rate of benefit accrual for the plan year may be determined as 1.33% of compensation for K's highest 3 consecutive years (1% for 20 years, plus 2% for 10 more years, with the sum divided by 30 equals 1.33%), and M's rate of benefit accrual for the plan year may be determined as 1% of compensation for O's highest 3 consecutive years (1% for 20 years, with that amount divided by 20 equals 1%).

(ii) If M were younger than age 55 (with 10 years of service and the same compensation history), M’s rate of benefit accrual for the plan year would be greater than 1% of compensation for M’s highest 3 consecutive years. (Plan A also provides for an impermissible reduction in the rate of benefit accrual for a participant whose service continues after normal retirement age in a manner that is comparable to Example 8(iii) of this paragraph (b)(3)(iii).) Thus, Plan A fails to satisfy paragraph (b)(3)(ii) of this section.

Example 10. (i) Employer Z maintains Plan Q, a defined benefit plan that provides an accrued benefit of $40 per month multiplied by a participant's years of credited service. Participant F attains normal retirement age of 65 and continues in the full time service of Z. At age 65, F has 30 years of credited service under the plan and could receive a normal retirement benefit of $1,200 per month ($40 X 30 years) if F retires. The plan suspends benefits for participants who work past normal retirement age, in accordance with section 411(a)(3)(B) and 29 CFR 2530.203-3 of the regulations of the Department of Labor, and does not provide for any actuarial increase for employment past normal retirement age. Accordingly, the plan does not pay F's accrued benefit while F remains in the full time service of Z and does not provide for an actuarial adjustment of F's accrued benefit because of delayed payment. For example, if F retires at age 67, after completing 2 additional years of credited service for Z, F will receive a benefit of $1,280 per month ($40 x 32 years) commencing at age 67.

(ii) Under Plan Q, the rate of accrual for all participants is $40 per month. Thus, there could not be any participant who would have a rate of benefit accrual that is greater than $40 per month if the participant were younger, so that there is no reduction in the rate of benefit accrual that is because of the individual’s attainment of any age under paragraph (b)(3)(i) of this section. Accordingly, Plan Q satisfies the requirements of section 411(b)(1)(H) and this paragraph (b).

Example 11. (i) Assume the same facts as in Example 10, except that the plan provides that the amount of F's benefit at normal retirement age will be actuarially increased for delayed retirement (even though the plan suspends benefits for participants who work past normal retirement age), and this actuarially increased benefit will be paid if it exceeds the plan formula, but no actuarial increase is provided for any amount that is accrued after normal retirement age. The plan takes this actuarial increase into account as part of the rate of benefit accrual in plan years ending after F's attainment of normal retirement age, as provided under paragraph (b)(2)(ii) of this section.

(ii) Under section 411(b)(1)(H) and this paragraph (b), F’s employment past normal retirement age cannot cause F’s rate of benefit accrual for any year to be less than $40 for the year. Plan Q satisfies this requirement for the first year after normal retirement age because, under the plan, F is entitled to receive, upon retirement at the end of the year when F is age 66, an actuarially increased benefit of $1,344.68 per month, so that the rate of benefit accrual for the year is $144.68 (which is $1,344.68 minus $1,200).

(iii) Further, for the second year past normal retirement age ending when F is age 67, F must be entitled to a rate of benefit accrual of at least $149.50 per month, which is the highest rate of benefit accrual under Plan Q for any younger participant with 32 years of service at the end of the year. (In these facts, all participants have a rate of accrual of $40 until normal retirement age and a participant who is age 66 with 32 years of service at the end of the year would have a rate of benefit accrual of $149.50 due to an actuarial increase on an age 65 benefit of $1,240 per month.) Under the plan, F is entitled to receive, upon retirement at age 67, an actuarially increased benefit of $1,511.39 per month. Plan Q satisfies the requirement that F be entitled to the highest rate of benefit accrual provided to any younger participant because the rate of benefit accrual in that year ($1,511.39 minus $1,344.68 equals $166.71) is not less than what the rate would be for F if F were younger. These same results would apply for any possible participant in Plan Q. Accordingly, Plan Q satisfies the requirements of section 411(b)(1)(H) and this paragraph (b).

Example 12. (i) Employer Z maintains Plan R, a defined benefit plan that provides an accrued benefit of 2% of the average of a participant's high 3 consecutive years of compensation multiplied by the participant's years of credited service under the plan. Participant G, who has attained normal retirement age (age 65) under the plan, continues in the full time service of Z. At normal retirement age, G has average compensation of $40,000 for G's high 3 consecutive years and has 10 years of credited service under the plan. Thus, at normal retirement age, G is entitled to receive an annual normal retirement benefit of $8,000 ($40,000 X .02 X 10 years). Payment of G's retirement benefit is not suspended, and the plan provides that retirement benefits that commence after a participant's normal retirement age are actuarially increased for late retirement. Under the plan provision relating to actuarial increase, the actuarial increase for the plan year is made to the benefit that would have been paid had the participant retired as of the end of the preceding plan year. The plan then provides the greater of this actuarially increased benefit and benefits under the plan formula based on continued service, thereby including the actuarial increase in the rate of benefit accrual in plan years ending after G's attainment of normal retirement age, as provided in paragraph (b)(2)(ii) of this section. The foregoing is illustrated in the following table with respect to certain years of credited service performed by G after attaining normal retirement age 65. (Certain numbers may not total due to rounding.)

Age at star t of plan year	Years of service at start of plan year	Average pay for high 3 consecutive years at start of plan year	Plan formula at start of plan year (.02 times column 2 times column 3)	Additional accruals for the plan year under plan formula (column 4 minus column 4 for prior year)	Annual benefit, as actuarially increased (column 8 from prior year actuarially increased)	Actuarial increase on the benefit at prior age (column 6 minus column 8 for prior year)	Annual benefit to which C is entitled at start of year (greater of column 4 or column 6)	Annual benefit as percent of average pay column 8 ÷ column 3)	Rate of benefit accrual (column 9 less column 9 for prior year)
(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**	**(7)**	**(8)**	**(9)**	**(10)**
65	10	$40,000	$8,000	n/a	n/a	n/a	$8,000	20%	2%
66	11	$42,000	$9,240	$1,240	$8,964	$964	$9,240	22%	2%
67	12	$58,000	$13,920	$4,680	$10,386	$1,142	$13,920	24%	2%
68	13	$60,000	$15,600	$1,680	$15,697	$1,777	$15,697	26.16%	2.16%
69	14	$66,000	$18,480	$2,880	$17,762	$2,065	$18,480	28%	1.84%
70	15	$68,000	$20,400	$1,920	$20,989	$2,509	$20,989	30.87%	2.87%

(ii) In the year G is 69 at the beginning of the year, G's rate of benefit accrual (1.84% of the average high 3 consecutive years of compensation) is lower than the rate of benefit accrual that would apply to a younger participant because a participant who is younger than age 65 with the same number of years of credited service and compensation history would have a rate equal to 2% of average high 3 consecutive years of compensation. Accordingly, Plan R fails to satisfy the requirements of section 411(b)(1)(H) and this paragraph (b).

Example 13. (i) The facts are the same as in Example 10, except that, under the plan provisions relating to retirement after normal retirement age, a participant's benefit is equal to the sum of the benefit that would have been paid had the participant retired as of the end of the preceding plan year and the greater of the actuarial increase for the plan year on that amount or the otherwise applicable accrual for the plan year under the plan formula. The foregoing is illustrated in the following table with respect to certain years of credited service performed by G after attaining normal retirement age 65.

Age at start of plan year	Years of service at start of plan year	Average pay for high 3 consecutive years at start of plan year	Plan formula at start of plan year (.02 times column 2 times column 3)	Additional accruals for the plan year under plan formula (column 4 minus column 4 for prior year)	Annual benefit, as actuarially increased (column 8 from prior year actuarially increased)	Actuarial increase on the benefit at prior age (column 6 minus column 8 for prior year)	Annual benefit to which C is entitled at start of year (column 8 at prior age plus the greater of column 5 and column 7)	Annual benefit as percent of average pay column 8 ÷ column 3)	Rate of benefit accrual (column 9 less column 9 for prior year)
(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**	**(7)**	**(8)**	**(9)**	**(10)**
65	10	$40,000	$8,000	n/a	n/a	n/a	$8,000	20%	2%
66	11	$42,000	$9,240	$1,240	$8,964	$964	$9,240	22%	2%
67	12	$58,000	$13,920	$4,680	$10,386	$1,142	$13,920	24%	2%
68	13	$60,000	$15,600	$1,680	$15,697	$1,777	$15,697	26.16%	2.16%
69	14	$66,000	$18,480	$2,880	$17,762	$2,065	$18,577	28.1%	2%
70	15	$68,000	$20,400	$1,920	$21,098	$2,521	$21,098	31.03%	2.93%

(ii) In the year G is 69 at the beginning of the year, G's rate of benefit accrual (2% of the average high 3 consecutive years of compensation) is not lower than the rate that would apply to G if G were younger. For example, if G were age 68 with the same 14 years of credited service and compensation history that G has at age 69, G would have a rate of benefit accrual equal to 2% of average high 3 consecutive years of compensation (in contrast to Example 12 in which the rate is 1.84% for an employee who is age 69 with 14 years of service, but would be 2% for younger employees with the same service and compensation history). Similar results would apply for any other potential younger participant in Plan R. Accordingly, Plan R satisfies the requirements of section 411(b)(1)(H) and this paragraph (b).

(iii) The decrease in G's rate of benefit accrual from 2.16% to 2% from age 68 to age 69 is not an impermissible reduction because of age. Under paragraph (b)(3) of this section, the determination of whether an impermissible reduction occurs because of age is made by comparing any potential participant's rate of benefit accrual to what the rate would be if the participant were younger (but with the same years of service, compensation history, and any other relevant factors taken into account under the plan), not by comparing a participant's rate in one year to that participant's rate in an earlier year. As indicated in paragraph (ii) of this Example 13, the rate of benefit accrual for a participant who is age 69 with 14 years of service at the beginning of the year is compared with the rate for all younger participants with the same service and compensation history. Similarly, the 2.16% rate for a participant who is age 68 with 13 years of service at the beginning of the year is compared with the rate for all younger participants with the same service and compensation history. Thus, for example, if G were age 67 with the same 13 years credited service and high 3 years of compensation equal to $60,000 that G has at age 68, G would have a rate of benefit accrual equal to 2.08% of average high 3 consecutive years of compensation.

(4) Certain adjustments for benefit distributions--(i) In general. Under section 411(b)(1)(H)(iii)(I), a defined benefit plan may provide that the requirement for continued benefit accrual under section 411(b)(1)(H)(i) and this paragraph (b) for a plan year is treated as satisfied to the extent of the actuarial equivalent of benefits distributed, as provided in this paragraph (b)(4). Distributions made before the participant attains normal retirement age or during a period that is not "section 203(a)(3)(B) service," as defined in 29 CFR 2530.203-3(c) of the regulations of the Department of Labor, may not be taken into account under this paragraph (b)(4).

(ii) Amount of the adjustment for benefits distributed. A defined benefit plan does not violate paragraph (b) of this section for a plan year merely because the rate of benefit accrual is reduced (but not below zero) to the extent of the actuarial equivalent of plan benefit distributions made to the participant during the plan year. For this purpose, distributions made during the plan year generally are disregarded for that year to the extent the actuarial value of the distributions exceeds the actuarial value of distributions that would have been made during the plan year had distribution of the participant's accrued benefit commenced at the beginning of the plan year (or, if later, at the participant's normal retirement age) in the normal form of benefit. (But see paragraph (b)(4)(iii) of this section for rules taking this excess into account at the end of the current year and in future years.) In addition, in any case in which the participant's benefits are being distributed in an optional form of benefit under which the amount payable annually is less than the amount payable under the plan's normal form of benefit (for example, a QJSA under which the annual benefit is less than the amount payable annually under a straight life annuity normal form), the plan may treat the participant as receiving payments under an actuarially equivalent normal form of benefit for the plan year and all future plan years.

(iii) Treatment of accelerated benefit payments--(A) Accelerated benefit payments. This paragraph (b)(4)(iii) applies if the actuarial value of the distributions made to the participant during a plan year exceeds the actuarial value of the distributions that would have been made during the plan year had distributions commenced at the beginning of the plan year (or, if later, at the participant's normal retirement age) in the normal form of benefit. In such a case, the excess payments (referred to as accelerated benefit payments) are converted to an actuarially equivalent stream of annual benefit payments under the plan's normal form of benefit, commencing at the beginning of the next plan year. This conversion must be based on the same actuarial assumptions used under the plan to determine the distributions made to the participant during the plan year. For purposes of this paragraph (b)(4)(iii), the actuarially equivalent stream of annual benefit payments is referred to as the annuity equivalent of accelerated benefit payments.

(B) Credit for annuity equivalent of accelerated benefit payments. For purposes of applying paragraphs (b)(4)(ii) and (iii)(C) of this section, the annuity equivalent of accelerated benefit payments is deemed to be paid to the participant in each plan year that begins after the plan year during which any accelerated benefit payment under paragraph (b)(4)(iii)(A) of this section is made.

(C) Effect of accelerated benefit payments on rate of benefit accrual. If any accelerated benefit payments under paragraph (b)(4)(iii)(A) of this section have been made to a participant, then, in lieu of determining the participant's rate of benefit accrual under paragraph (b)(2)(ii) of this section, the participant's rate of benefit accrual for a plan year is determined as the excess (if any) of--

(1) The sum of the annual benefit to which the participant is entitled at the end of the current plan year, assuming payment commences in the normal form at the end of the current plan year, plus the amount deemed paid in the next plan year under the annuity equivalent of accelerated benefit payments; over

(2) The sum of the annual benefit to which the participant was entitled at the end of the preceding plan year, assuming that payment commences in the normal form at the later

of normal retirement age and the end of the preceding plan year, plus the amount deemed paid during the current plan year under the annuity equivalent of accelerated benefit payments.

(iv) Examples. The provisions of this paragraph (b)(4) may be illustrated by the following examples. In each of the examples, except as otherwise indicated, normal retirement age is 65 and the birthday of each participant is assumed to be January 1. In addition, except as otherwise indicated, the plan contains no limitations on the maximum amount of benefits the plan will pay to any participant (other than the limitations imposed by section 415), on the maximum number of years of credited service taken into account under the plan, or on the compensation used for purposes of determining the amount of any participant's normal retirement benefit (other than the limitation imposed by section 401(a)(17)) and the plan uses the following actuarial assumptions for purposes of determining the amount of any participant's accrued benefit (other than the limitation imposed by section 401(a)(17)), and the plan uses the following actuarial assumptions in determining actuarial equivalence: a 7.5% rate of interest and the 83 GAM (male) mortality table. The examples are as follows:

Example 1. (i) Facts relating to the year in which participant attains age 65. Employer Z maintains Plan Q, a defined benefit plan that provides an accrued benefit of $40 per month multiplied by the participant's years of credited service. Participant F attains normal retirement age of 65 on January 1 and continues in the full time service of Z. At the end of the year in which F attains age 65, F has 30 years of credited service under the plan and could receive an accrued benefit of $1,200 per month ($40 x 30 years) if F retires. Plan Q does not suspend payment of benefits for participants who work past normal retirement age and F commences benefit payments at normal retirement age. (These are the same facts as in Example 10 of paragraph (b)(3)(iii) of this section, except that the Plan Q does not provide for the suspension of normal retirement benefit payments.) The plan offsets the value of the benefit distributions against benefit accruals in plan years ending after the participant's attainment of normal retirement age, as permitted by paragraph (b)(4)(ii) of this section. Participant F (who remains in the full time service of Y) receives 12 monthly benefit payments after attainment of age 65 and prior to attainment of age 66. The total monthly benefit payments of $14,400 ($1,200 x 12 payments) have an actuarial value at the end of the year in which F turns 65 of $15,118 (reflecting interest and mortality) which would produce a monthly life annuity benefit of $145 commencing at age 66. The rate of benefit accrual otherwise applicable under the plan formula for the year of credited service F completes after attaining normal retirement age is $40 per month.

(ii) Conclusions relating to the year in which F attains age 65. Because the actuarial value (determined as a monthly benefit of $145) of the benefit payments made during the first year after F's attainment of normal retirement age exceeds the benefit accrual otherwise applicable for the first year after F's attainment of normal retirement age, the plan is not required to accrue benefits on behalf of F for the one year of credited service after F's attainment of normal retirement age and the plan is not required to increase F's monthly benefit payment of $1,200 during the year in which F attains age 65.

(iii) Facts relating to the year in which F attains age 66. Assume F receives 12 additional monthly benefit payments the next year prior to F's retirement at the end of the next year when F attains age 66. The total monthly benefit payments of $14,400 ($1,200 x 12 payments) have an actuarial value at the end of that year of $15,135 (reflecting interest and mortality) which would produce a monthly benefit payment of $149 commencing at age 67. The rate of benefit accrual otherwise applicable under the plan formula for the additional year of credited service F completed that year is $40 per month.

(iv) Conclusions relating to the year in which F attains age 66. Because the actuarial value (determined as a monthly benefit of $149) of the benefit payments made during that year exceeds the benefit accrual otherwise applicable for the additional year of credited service, the plan is not required to accrue benefits on behalf of F for the second year of credited service F completed after attaining normal retirement age and the plan is not required to increase F's monthly benefit payment of $1,200.

Example 2. (i) Facts. Employer Z maintains Plan R, a defined benefit plan that provides an accrued benefit of 2% of the average of a participant's high 3 consecutive years of compensation multiplied by the participant's years of credited service under the plan. Payment of a participant’s retirement benefit is not suspended, and the plan provides that retirement benefits that commence after a participant's normal retirement age are actuarially increased for late retirement. Under the plan provision relating to actuarial increase, the actuarial increase for the plan year is made to the benefit that would have been paid had the participant retired as of the end of the preceding plan year. The plan then provides the greater of this actuarially increased benefit and benefits under the plan formula based on continued service, thereby including the actuarial increase in the rate of benefit accrual in plan years ending after attainment of normal retirement age, as provided in paragraph (b)(2)(ii) of this section. Participant G, who has attained normal retirement age (age 65) under the plan, continues in the full time service of Z. At normal retirement age, G has average compensation of $40,000 for G's high 3 consecutive years and has 10 years of credited service under the plan. Thus, at normal retirement age, G is entitled to receive an annual normal retirement benefit of $8,000 ($40,000 x .02 x 10 years). G continues working after normal retirement age, with G's average compensation increasing to $68,000 at age 70. (The facts in this Example 2 are the same as Example 13 of paragraph (b)(3)(ii) of this section, except that the employee does not retire at age 70, but continues in the full time service of Z.) Upon G's attainment of age 70, the plan commences benefit payments to G. The annual benefit paid to G in the first plan year is $21,098. In determining the annual benefit payable to G in each subsequent plan year, the plan offsets the value of benefit distributions made to the participant by the close of the prior plan year against benefit accruals otherwise applicable in plan years during which such distributions were made, as permitted by paragraph (b)(4)(ii)(B) of this section.

(ii) Conclusion. Accordingly, for each subsequent plan year, G is entitled under the plan to receive benefit payments based on G's benefit at the close of the prior plan year, plus the excess (if any) of the benefit for the plan year determined under the plan formula otherwise applicable over the value of total benefit distributions made to G during the plan year. The foregoing is illustrated in the following table with respect to certain years of credited service performed by G while benefits were being distributed to G.

Age at start of plan year	Years of service at start of plan year	Average pay for high 3 consecutive years at start of plan year	Plan formula at start of plan year (.02 times column 2 times column 3)	Additional accruals for the plan year under plan formula (column 4 minus column 4 for prior year)	Benefit distributions made during the prior year	Annual benefit that is actuarial equivalent of column 6	Annual benefit to which G is entitled at end of the year (column 8 for prior year, plus the excess, if any of column 5 for the current year, over column 7 for current year)
(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**	**(7)**	**(8)**
70	15	$68,000	$20,400	$1,920	none	none	$21,098
71	16	$70,000	$22,400	$2,000	$21,098	$2,799	$21,098
72	17	$90,000	$30,600	$8,200	$21,098	$2,891	$26,407
73	18	$100,000	$36,000	$5,400	$26,407	$3,743	$28,065

Example 3. (i) Facts relating to the year in which a participant attains age 65. Plan X provides an accrued benefit equal to 1% of the average of a participant's highest 3 consecutive years of compensation times the participant's years of service, payable in the normal form of a straight life annuity commencing at normal retirement age or at the date of actual retirement if later. Plan X permits a participant who is an employee to commence distributions after attainment of normal retirement age (age 65) and provides for benefits otherwise accrued after normal retirement age to be offset by the actuarial equivalent of any benefit distributions made to the participant. Plan X provides for a participant who does not commence distributions to receive an actuarial increase for the year from the amount payable at the end of the preceding year (if greater than the amount otherwise accrued for H during the year under X's formula). Participant H attains age 65 on the first day of a plan year when Participant H's average highest 3 consecutive years of compensation is $60,000 and H has 20 years of service. Accordingly, Participant H's accrued benefit at the beginning of the year is equal to a straight life annuity of $1,000 per month (20% times $60,000 divided by 12) commencing at the beginning of the year. Participant H elects to receive a single-sum distribution of $130,389 at the beginning of the year, which is equal to the present value of H's accrued benefit under section 417(e) at that time. Participant H continues to work through the end of the plan year and at the end of the year has average compensation of $60,000 for the year. Plan X uses the actuarial assumptions specified in section 417(e) for purposes of determining actuarial equivalence. For purposes of this Example 3, the applicable interest rate under section 417(e) is assumed to be 6%, and the applicable mortality table under section 417(e) is the mortality table in effect on January 1, 2003.

(ii) Conclusion relating to effect of distributions made in the year H attains age 65. Under this paragraph (b)(4), H would otherwise accrue an additional monthly benefit of $50 for the additional year of service under the plan's formula (21% times $60,000 minus 20% times $60,000, divided by 12). The plan is permitted under section 411(b)(1)(H)(iii)(I) to offset additional accruals otherwise applicable after normal retirement age by the actuarial value of distributions made during the year. However, under paragraph (b)(4)(ii) of this section, distributions made during a plan year are disregarded to the extent that the actuarial value of the distributions exceeds the actuarial value of distributions that would have been made during the plan year had distribution of the participant's accrued benefit commenced at the beginning of the plan year under the plan's normal form.

(iii) Conclusion relating to calculations for distribution made in the year H attains age 65. At the end of the year, the actuarial value of the distribution made to H ($130,389 plus interest and mortality for the year equals $139,812) is greater than the year end actuarial value of distributions that would have been made during the plan year had distribution of the participant's accrued benefit at the beginning of the plan year commenced in the normal form at the beginning of the plan year (which is $12,470, based on the plan's actuarial assumptions). Accordingly, the $127,342 excess (referred to as an accelerated benefit payment) is disregarded in the current year. (However, as described below, the annuity equivalent of the $127,342 is deemed to be paid to H commencing at the beginning of the first plan year after the plan year during which the accelerated benefit payment is made.)

(iv) Conclusion relating to rate of benefit accrual for the year H attains age 65. To determine the rate of benefit accrual for the year in which H attains age 65, the annuity equivalent of accelerated benefit payments is calculated and, under paragraph (b)(4)(iii)(C) of this section, this amount is treated as part of the benefit payable at the end of the year in calculating the rate of benefit accrual for the year. In this Example 3, the annuity equivalent of the $127,342 accelerated benefit payment equals a straight life annuity of $1,000 per month commencing at the beginning of the next plan year. Thus, for purposes of applying paragraph (b)(4)(iii) of this section to determine the rate of benefit accrual for the plan year in which H attains age 65, paragraph (b)(4)(iii)(C)(1) of this section is an annual straight life annuity commencing at end of the year equal to $1,000 (the sum of the annual benefit to which the H is entitled at the end of the plan year, which is zero in this case, plus the amount deemed paid in the next plan year under the annuity equivalent of accelerated benefit payments, which is $1,000 in this case) and the amount in paragraph (b)(4)(iii)(C)(2) of this section is an annual straight life annuity commencing at end of the preceding plan year equal to $1,000. Thus, H's rate of benefit accrual for the year is zero.

(v) Conclusion relating to whether rate of benefit accrual for year H attains age 65 satisfies section 411(b)(1)(H). Under paragraph (b)(4)(ii) of this section, a plan may reduce the rate of benefit accrual otherwise applicable to the extent of distributions made during the year. The actuarial equivalent of $12,470 (the actuarial value of the 12 $1,000 monthly payments deemed paid to H during the plan year under paragraph (b)(4)(ii) of this section) is a straight life annuity commencing at the end of the plan year equal to $98 per month. Thus, the otherwise applicable accrual for the year may be reduced (but not below zero) by $98 per month. The highest rate of benefit accrual for any participant with H's service and compensation history who is younger is an annual straight life annuity of $50 per month. Because the permissible reduction of $98 per month is not less than the otherwise applicable accrual of $50 per month, Plan X is not required by this paragraph (b) for the year and section 411(b)(1)(H) to provide H with any additional accruals for the year.

(vi) Conclusion relating to rate of benefit accrual for year H attains age 65 if no distribution were made. If Participant H had not elected to receive any distribution during the plan year, then H's accrued benefit at the end of the year would be a straight life annuity of $1,098 per month commencing at the end of the year (which is actuarially equivalent to a straight life annuity of $1,000 per month commencing at the beginning of the year). Thus, H's rate of benefit accrual for that year would be $98 (but no adjustments for any distribution would apply).

(vii) Facts relating to next year in which H attains age 66. Participant H works another year and H's average compensation becomes $70,000. Under this paragraph (b)(4), H would otherwise accrue an additional monthly benefit of $233 for the additional year of service under the plan's formula (22% times $70,000, minus 21% times $60,000, divided by 12). However, the plan is permitted under section 411(b)(1)(H)(iii)(I) to offset additional accruals after normal retirement age by the actuarial value of distributions made during the year. Under paragraph (b)(4)(iii)(B) of this section, the $1,000 annuity equivalent of accelerated benefit payments is deemed to be paid to H during this second year when H attains age 66. These deemed payments are actuarially equivalent to an accrual of $100 per month payable at the end of that year. Accordingly, the plan reduces the otherwise applicable accrual of $233 to the extent of the accrual of $100 per month payable at the end of the year in which H attains age 66. Thus, the $233 accrual during the year in which H becomes 66 is reduced by $100 to $133. Under the plan X, H's accrued benefit at the end of the year is $133 per month.

(viii) Conclusion relating to rate of benefit accrual for year H attains age 66. To determine the rate of benefit accrual for the second year when H attains age 66, the annuity equivalent of accelerated benefit payments is calculated and, under paragraph (b)(4)(iii)(C) of this section, this amount is treated as part of the benefit payable at the end of the year in calculating the rate of benefit accrual for the second year. In this Example 3, the annuity equivalent of the $127,342 accelerated benefit payment that was made in the year in which H attained age 65 equals a straight life annuity of $1,000 per month commencing at the beginning of the next plan year. Thus, for purposes of applying paragraph (b)(4)(iii) of this section to determine the rate of benefit accrual for the second plan year, the amount in paragraph (b)(4)(iii)(C)(1) of this section is an annual straight life annuity commencing at end of the year equal to $1,133 (the sum of the annual benefit to which the H is entitled at the end of the plan year, which is $133 in this case, plus the amount deemed paid in the next plan year under the annuity equivalent of accelerated benefit payments, which is $1,000 in this case) and the amount in paragraph (b)(4)(iii)(C)(2) of this section is an annual straight life annuity commencing at end of the preceding plan year equal to $1,000. Thus, H's rate of benefit accrual for the year in which H becomes age 66 is $133.

(ix) Conclusion relating to whether rate of benefit accrual for year H becomes 66 satisfies section 411(b)(1)(H). Under paragraph (b)(4))(ii) of this section, a plan may reduce the rate of benefit accrual to the extent of distributions made during the year. The actuarial equivalent of $12,480 (the actuarial value of the 12 $1,000 monthly payments deemed made to H during the plan year) is a straight life annuity commencing at the end of the plan year equal to $100 per month. Thus, the otherwise applicable accrual for the year may be reduced (but not below zero) by $100 per month. The highest rate of benefit accrual for any participant with H's service and compensation history who is younger is an annual straight life annuity of $233 per month. Thus, because the sum of $133 and $100 is not less than the otherwise applicable accrual of $233 per month, Plan X satisfies this paragraph (b) and section 411(b)(1)(H) for the year.

(c) Defined contribution plans--(1) In general. A defined contribution plan (including a target benefit plan described in §1.410(a)-4(a)(1)) does not satisfy the requirements of section 411(b)(2) if the rate of allocation made to the account of a participant is reduced, either directly or indirectly, because of the participant's attainment of any age. A reduction in the rate of allocation includes any discontinuance in the allocation of employer contributions or forfeitures to the account of the participant or cessation of participation in the plan.

(2) Rate of allocation--(i) Aggregate allocations. For purposes of this paragraph (c), a participant's rate of allocation for any plan year is the aggregate allocations taken into account for the plan year under §1.401(a)(4)-2(c)(2).

(ii) Determination of rate of allocation. A participant's rate of allocation for a plan year can be determined as a dollar amount. Alternatively, if a plan's formula bases a participant's allocations solely on compensation for the plan year and compensation is determined without regard to attainment of any age, then a participant's rate of allocation can be determined as a percentage of the participant's compensation for the plan year.

(3) Reduction that is directly or indirectly because of a participant's attainment of any age--(i) Reduction in rate of allocation that is directly because of a participant's attainment of any age. A plan provides for a reduction in the rate of allocation that is directly because of a participant's attainment of any age for any plan year if, under the terms of the plan, any participant's rate of allocation for the plan year would be higher if the

participant were younger. Thus, a plan fails to satisfy section 411(b)(2) and this paragraph (c) if, under the terms of the plan, the rate of allocation for any individual who is or could be a participant under the plan would be lower solely as a result of such individual being older.

(ii) Reduction in rate of allocation that is indirectly because of a participant's attainment of any age--(A) In general. A plan provides for a reduction in the rate of allocation that is indirectly because of a participant's attainment of any age for any plan year if any participant's rate of allocation for the plan year would be higher if the participant were to have a characteristic that is a proxy for being younger, based on all of the relevant facts and circumstances. Thus, a plan fails to satisfy section 411(b)(2) and this paragraph (c) if the rate of allocation for any individual who is or could be a participant under the plan would be lower solely as a result of such individual having a different characteristic which is a proxy for being older, based on applicable facts and circumstances.

(B) Treatment of limitations. A reduction in a participant's rate of allocation is not indirectly because of the attainment of any age in violation of section 411(b)(2) solely because of a positive correlation between attainment of any age and a reduction in the rate of allocation. Thus, a defined contribution plan (including a target benefit plan described in §1.410(a)-4(a)(1)) does not fail to satisfy the minimum vesting standards of section 411(a) solely because the plan limits the total amount of employer contributions and forfeitures that may be allocated to a participant's account (for a particular plan year or for the participant's total years of credited service under the plan), solely because the plan limits the total number of years of credited service for which a participant's account may receive allocations of employer contributions and forfeitures, or solely because the plan limits the number of years of credited service that may be taken into account for purposes of determining the amount of, or the rate at which, employer contributions and forfeitures are allocated to a participant's account for a particular plan year.

(iii) Special rule for target benefit plans. A defined contribution plan that is a target benefit plan, as defined in §1.410(a)-4(a)(1), satisfies section 411(b)(2) only if the defined benefit formula used to determine allocations would satisfy section 411(b)(1)(H) without regard to section 411(b)(1)(H)(iii). Such a target benefit plan does not fail to satisfy this paragraph (c) with respect to allocations after normal retirement age merely because the allocation for a plan year is reduced to reflect shorter longevity using a reasonable actuarial assumption regarding mortality.

(iv) Additional rules. The Commissioner may prescribe additional guidance, published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter), with respect to the application of section 411(b)(2) and this section to target benefit plans.

(d) Benefits and forms of benefits subject to requirements--(1) General rule. Except as provided in paragraph (d)(2) or (3) of this section, sections 411(b)(1)(H) and 411(b)(2) and paragraphs (b) and (c) of this section apply to all benefits (and forms of benefits) provided under the plan, including accrued benefits, benefits described in section 411(d)(6), ancillary benefits, and other rights and features provided under the plan. Accordingly, except as provided in paragraph (d)(2) or (3) of this section, a participant's rate of benefit accrual under a defined benefit plan and a participant's allocations under a defined contribution plan are considered to be reduced because of the participant's attainment of any age if optional forms of benefits, ancillary benefits, or other rights or features under the plan provided with respect to benefits or allocations attributable to credited service prior to the attainment of the participant's age are not provided on at least as favorable a basis with respect to benefits or allocations attributable to credited service after attainment of the participant's age. Thus, for example, a plan may not provide a single-sum payment only with respect to benefits attributable to years of credited service before the attainment of a specified age. Similarly, except as provided in paragraph (d)(2) or (3) of this section, if an optional form of benefit is available under the plan at a specified age, the availability of that form of benefit, or the method for determining the manner in which that form of benefit is paid, may not, directly or indirectly, be denied or provided on terms less favorable to participants because of the attainment of any age. Similarly, if the method for determining the amount or the rate of the subsidized portion of a joint and survivor annuity or the subsidized portion of a preretirement survivor annuity is less favorable with respect to participants who have attained a specified age than with respect to participants who have not attained such age, benefit accruals or account allocations under the plan will be considered to be reduced because of the attainment of such age.

(2) Special rule for actuarial assumptions regarding mortality. A plan does not fail to satisfy section 411(b)(1)(H) or this paragraph (d) merely because the plan makes actuarial adjustments using a reasonable assumption regarding mortality to calculate optional forms of benefit or to calculate the cost of providing a qualified preretirement survivor annuity, as defined in section 417(c).

(3) Special rule for certain benefits. A plan does not fail to satisfy section 411(b)(1)(H) or this paragraph (d) merely because the following benefits, or the manner in

which such benefits are provided under the plan, vary because of the attainment of any higher age--

(i) The subsidized portion of an early retirement benefit (whether provided on a temporary or permanent basis);

(ii) A qualified disability benefit (as defined in §1.411(a)-7(c)(3)); or

(iii) A social security supplement (as defined in §1.411(a)-7(c)(4)(ii)).

(e) Coordination with certain provisions. Notwithstanding section 411(b)(1)(H), section 411(b)(2), and paragraphs (a) through (d) of this section, the following rules apply--

(1) Section 415 limitations. No benefit accrual with respect to a participant in a defined benefit plan is required for a plan year by section 411(b)(1)(H)(i) and no allocation to the account of a participant in a defined contribution plan (including a target benefit plan described in §1.410(a)-4(a)(1)) is required for a plan year by section 411(b)(2) to the extent that the allocation or accrual would cause the plan to exceed the limitations of section 415.

(2) Prohibited discrimination--(i) No benefit accrual on behalf of a highly compensated employee in a defined benefit plan is required for a plan year by section 411(b)(1)(H)(i) to the extent such benefit accrual would cause the plan to discriminate in favor of highly compensated employees within the meaning of section 401(a)(4).

(ii) No allocation to the account of a highly compensated employee in a defined contribution plan (including a target benefit plan) is required for a plan year by section 411(b)(2) to the extent the allocation would cause the plan to discriminate in favor of highly compensated employees within the meaning of section 401(a)(4).

(iii) The Commissioner may provide additional guidance, published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter), relating to prohibited discrimination in favor of highly compensated employees.

(3) Permitted disparity. A defined benefit plan does not fail to satisfy section 411(b)(1)(H) for a plan year and a defined contribution plan does not fail to satisfy 411(b)(2) for a plan year merely because accruals or allocations under the plan are reduced to satisfy the uniformity requirements of §1.401(*l*)-2(c) or 1.401(*l*)-3(c) for the plan year.

(4) Distribution rights under section 411. A defined benefit plan does not fail to satisfy section 411(b)(1)(H) for a plan year and a defined contribution plan does not fail to satisfy 411(b)(2) for a plan year merely because of the right to defer distributions provided under section 411(a)(11) or a plan provision consistent with section 411(a)(11).

(f) Effective dates--(1) Effective date of sections 411(b)(1)(H) and 411(b)(2) for noncollectively bargained plans--(i) In general. Except as otherwise provided in paragraph (f)(2) of this section, sections 411(b)(1)(H) and 411(b)(2) are applicable for plan years beginning on or after January 1, 1988, with respect to a participant who is credited with at least 1 hour of service in a plan year beginning on or after January 1, 1988. Neither section 411(b)(1)(H) nor section 411(b)(2) is applicable with respect to a participant who is not credited with at least 1 hour of service in a plan year beginning on or after January 1, 1988.

(ii) Defined benefit plans. In the case of a participant who is credited with at least 1 hour of service in a plan year beginning on or after January 1, 1988, section 411(b)(1)(H) is applicable with respect to all years of service completed by the participant other than plan years beginning before January 1, 1988.

(iii) Defined contribution plans. Section 411(b)(2) does not apply with respect to allocations of employer contributions or forfeitures to the accounts of participants under a defined contribution plan for a plan year beginning before January 1, 1988.

(iv) Hour of service. For purposes of this paragraph (f)(1), 1 hour of service means 1 hour of service recognized under the plan or required to be recognized under the plan by section 410 (relating to minimum participation standards) or section 411 (relating to minimum vesting standards). In the case of a plan that does not determine service on the basis of hours of service, 1 hour of service means any service recognized under the plan or required to be recognized under the plan by section 410 (relating to minimum participation standards) or section 411 (relating to minimum vesting standards).

(2) Effective date of sections 411(b)(1)(H) and 411(b)(2) for collectively bargained plans--(i) In the case of a plan maintained pursuant to 1 or more collective bargaining agreements between employee representatives and 1 or more employers, ratified before March 1, 1986, sections 411(b)(1)(H) and 411(b)(2) are applicable for benefits provided under, and employees covered by, any such agreement with respect to plan years beginning on or after the later of--

(A) January 1, 1988; or

(B) The earlier of January 1, 1990, or the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension of any such agreement occurring on or after March 1, 1986).

(ii) The applicability date provisions of paragraph (f)(1) of this section shall apply in the same manner to plans described in paragraph (f)(2)(i) of this section, except that the applicable date determined under paragraph (f)(2)(i) of this section shall be substituted for the effective date determined under paragraph (f)(1) of this section.

(iii) In accordance with the provisions of paragraph (f)(2)(i) of this section, a plan described therein may be subject to different applicability dates under sections 411(b)(1)(H) and 411(b)(2) for employees who are covered by a collective bargaining agreement and employees who are not covered by a collective bargaining agreement.

(iv) For purposes of paragraph (f)(2)(i) of this section, the service crediting rules of paragraph (f)(1) of this section shall apply to a plan described in paragraph (f)(2)(i) of this section, except that in applying such rules the applicability date determined under paragraph (f)(2)(i) of this section shall be substituted for the applicability date determined under paragraph (f)(1) of this section. See paragraph (f)(1)(iv) of this section for rules relating to the recognition of an hour of service.

(3) Regulatory effective date. Paragraphs (a) through (e) of this section are applicable with respect to plan years beginning on or after the date of publication of final regulations in the **Federal Register**.

David A. Mader

Assistant Deputy Commissioner of Internal Revenue.