bond only if it is a qualified bond. A qualified bond includes an exempt facility bond, defined as any bond issued as part of an issue 95 percent or more of the net proceeds of which are used to provide a facility specified in section 142. One type of facility specified in section 142(a) is a sewage facility. This section defines the term *sewage facility* for purposes of section 142(a).

(b) *Definitions*—(1) *Sewage facility defined.* A sewage facility is property—

(i) Except as provided in paragraphs (b)(2) and (d) of this section, used for the secondary treatment of wastewater; however, for property treating wastewater reasonably expected to have an average daily raw wasteload concentration of biochemical oxygen demand (BOD) that exceeds 350 milligrams per liter as oxygen (measured at the time the influent enters the facility) (the *BOD limit*), this paragraph (b)(1)(i) applies only to the extent the treatment is for wastewater having an average daily raw wasteload concentration of BOD that does not exceed the BOD limit;

(ii) Used for the preliminary and/or primary treatment of wastewater but only to the extent used in connection with secondary treatment (without regard to the BOD limit described in paragraph (b)(1)(i) of this section);

(iii) Used for the advanced or tertiary treatment of wastewater but only to the extent used in connection with and after secondary treatment;

(iv) Used for the collection, storage, use, processing, or final disposal of—

(A) Wastewater, which property is necessary for such preliminary, primary, secondary, advanced, or tertiary treatment; or

(B) Sewage sludge removed during such preliminary, primary, secondary, advanced, or tertiary treatment (without regard to the BOD limit described in paragraph (b)(1)(i) of this section);

(v) Used for the treatment, collection, storage, use, processing, or final disposal of septage (without regard to the BOD limit described in paragraph (b)(1)(i) of this section); and

(vi) Functionally related and subordinate to property described in this paragraph (b)(1), such as sewage disinfection property.

(2) *Special rules and exceptions*—(i) *Exception to BOD limit.* A facility treating wastewater with an average daily raw wasteload concentration of BOD exceeding the BOD limit will not fail to qualify as a sewage facility described in paragraph (b)(1) of this section to the extent that the failure to satisfy the BOD limit results from the implementation of a federal, state, or local water conservation program (for example, a program designed to promote water use efficiency that results in BOD concentrations beyond the BOD limit).

(ii) *Anti-abuse rule for BOD limit.* A facility does not satisfy the BOD limit if there is any intentional manipulation of the BOD level to circumvent the BOD limit (for example, increasing the volume of water in the wastewater before the influent enters the facility with the intention of reducing the BOD level).

(iii) *Authority of Commissioner.* In appropriate cases upon application to the Commissioner, the Commissioner may determine that facilities employing technologically advanced or innovative treatment processes qualify as sewage facilities if it is demonstrated that these facilities perform functions that are consistent with the definition of sewage facilities described in paragraph (b)(1) of this section.

(3) *Other applicable definitions*—(i) *Advanced or tertiary treatment* means the treatment of wastewater after secondary treatment. Advanced or tertiary treatment ranges from biological treatment extensions to physical-chemical separation techniques such as denitrification, ammonia stripping, carbon adsorption, and chemical precipitation.

(ii) *Nonconventional pollutants* are any pollutants that are not listed in 40 CFR 401.15, 401.16, or appendix A to part 423.

(iii) *Preliminary treatment* means treatment that removes large extraneous matter from incoming wastewater and renders the incoming wastewater more amenable to subsequent treatment and handling.

(iv) *Pretreatment* means a process that preconditions wastewater to neutralize or remove toxic, priority, or nonconventional pollutants that could adversely affect sewers or inhibit a preliminary, primary, secondary, advanced, or tertiary treatment operation.

(v) *Primary treatment* means treatment that removes material that floats or will settle, usually by screens or settling tanks.

(vi) *Priority pollutants* are those pollutants listed in appendix A to 40 CFR part 423.

(vii) *Secondary treatment* means the stage in sewage treatment in which a bacterial process (or an equivalent process) consumes the organic parts of wastes, usually by trickling filters or an activated sludge process.

(viii) *Sewage sludge* is defined in 40 CFR 122.2 and includes septage.

(ix) *Toxic pollutants* are those pollutants listed in 40 CFR 401.15.

(c) *Other property not included in the definition of a sewage facility.* Property other than property described in paragraph (b)(1) of this section is not a sewage facility. Thus, for example, property is not a sewage facility, or functionally related and subordinate property, if the property is used for pretreatment of wastewater (whether or not this treatment is necessary to perform preliminary, primary, secondary, advanced, or tertiary treatment), or the related collection, storage, use, processing, or final disposal of the wastewater. In addition, property used to treat, process, or use wastewater subsequent to the time the wastewater can be discharged into navigable waters, as defined in 33 U.S.C. 1362, is not a sewage facility.

(d) *Allocation of costs.* In the case of property that has both a use described in paragraph (b)(1) of this section (a sewage treatment function) and a use other than sewage treatment, only the portion of the cost of the property allocable to the sewage treatment function is taken into account as an expenditure to provide sewage facilities. The portion of the cost of property allocable to the sewage treatment function is determined by allocating the cost of that property between the property's sewage treatment function and any other uses by any method which, based on all the facts and circumstances, reasonably reflects a separation of costs for each use of the property.

(e) *Effective date*—(1) *In general.* This section applies to issues of bonds issued after February 21, 1995.

(2) *Refundings.* In the case of a refunding bond issued to refund a bond to which this section does not apply, the issuer need not apply this section to that refunding bond. This paragraph (e)(2) applies only if the weighted average maturity of the refunding bonds, as described in section 147(b), is not greater than the remaining weighted average maturity of the refunded bonds.

**Margaret Milner Richardson,**

*Commissioner of Internal Revenue.*

Approved: December 2, 1994.

**Leslie Samuels,**

*Assistant Secretary of the Treasury.*

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26 CFR Part 1

[TD 8581]

RIN 1545–AQ87

## Certain Cash or Deferred Arrangements and Employee and Matching Contributions Under Employee Plans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document amends final regulations governing certain cash or deferred arrangements and employee and matching contributions under employee plans. The amendments add cross-references to final regulations relating to nondiscrimination, minimum coverage, and related requirements, since the publication of the final regulations relating to cash or deferred arrangements and employee and matching contributions. The amendments also make various technical corrections to and clarifications of the final regulations governing cash or deferred arrangements and employee and matching contributions under employee plans, the final regulations relating to plan amendments reducing accrued benefits, and the final regulations relating to maximum contributions and benefits.

EFFECTIVE DATE: These regulations are effective August 15, 1991.

FOR FURTHER INFORMATION CONTACT: Catherine Livingston Fernandez at 202–622–4606 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

### Background

Final regulations under sections 401(a)(30), 401(k), 401(m), 402(a)(8), 402(g), 411(d)(6), 415(c), 416, and 4979 of the Internal Revenue Code (Code) were published in the **Federal Register** on August 15, 1991 (56 FR 40507). Amendments to the final regulations were published in the **Federal Register** on December 4, 1991 (56 FR 63420). Minor corrections to the final regulations were published in the **Federal Register** on March 25, 1992 (57 FR 10289), on December 17, 1992 (57 FR 59915), and on March 16, 1993 (58 FR 14150). The final regulations published on August 15, 1991, as amended and corrected on or before March 16, 1993, are referred to herein as "the 1991 Final Regulations."

Proposed amendments to the 1991 Final Regulations were published in the **Federal Register** on August 10, 1992 (57 FR 35536), and on January 4, 1993 (58 FR 43). A minor correction to the amendment proposed on January 4, 1993, was published in the Federal Register on March 22, 1993 (58 FR 15312). The amendments made by this document include these previously proposed amendments.

### Explanation of Provisions

*1. Coordination With Regulations Under Sections 401(a)(4), 401(a)(17), 410(b), and 414(s)*

Final regulations under section 401(a)(4) were published in the **Federal Register** on September 3, 1993 (58 FR 46773). Final regulations under section 401(a)(17) were published in the Federal Register on June 27, 1994 (59 FR 32903). Final regulations under section 410(b) were published in the **Federal Register** on September 19, 1991 (56 FR 47638). Amendments to the regulations under section 410(b) were published in the **Federal Register** on December 4, 1991 (56 FR 63420), September 3, 1993 (58 FR 46835), and June 27, 1994 (59 FR 32911). Final regulations under section 414(s) were published in the **Federal Register** on September 19, 1991 (56 FR 47659). Amendments to the regulations under section 414(s) were published in the **Federal Register** on September 7, 1993 (58 FR 47061).

A number of provisions of the final regulations under sections 401(a)(4) and (17), 410(b), and 414(s) affect plans subject to the regulations governing cash or deferred arrangements and employee and matching contributions. The preamble to the 1991 Final Regulations states that "when final regulations are issued under section 410(b), these [section 410(k) and (m)] regulations will be revised to cross-refer to definitions of common applicability under sections 410(b), 401(k), and 401(m)." (56 FR 40507, 40511 (August 15, 1991)). Therefore, this document amends final regulations under sections 401(k) and (m), 402(g), and 4979 by inserting cross-references to the relevant provisions of the regulations under sections 401(a)(4) and (17), 410(b), and 414(s).

*2. Scope of These Amendments*

Questions and comments received with respect to the 1991 Final Regulations have suggested that some technical corrections or clarifications would be helpful. Accordingly, in addition to inserting cross-references as described above, the amendments made by this document (referred to herein as the *1994 Amendments*) make a number of technical corrections and clarifications. More significant changes are beyond the scope of this package, but may be considered at a later date. Treasury and the IRS continue to welcome comments concerning the regulations.

*3. Use of Term "Section 401(k) Plan" to Reflect Special Nondiscrimination Testing Requirements for QNECs Under Sections 401(a)(4) and 410(b)*

Among the terms of common applicability under sections 410(b), 401(k), and 401(m) is the term "section 401(k) plan," which is defined in the regulations under sections 401(a)(4) and 410(b). Those regulations define a "section 401(k) plan" as consisting only of the elective contributions under a qualified cash or deferred arrangement (CODA). See § 1.410(b)–9. Qualified nonelective contributions (QNECs) that are used to pass the actual deferral percentage (ADP) test are not treated as part of a section 401(k) plan under those regulations and must be tested separately for nondiscrimination under sections 401(a)(4) and 410(b). See §§ 1.401(a)(4)–1(b)(2)(ii)(B) and 1.410(b)–7(c)(1). Thus, while QNECs may be used to pass the ADP test (and in fact are included in the definition of a CODA under the section 401(k) regulations at § 1.401(k)–1(b)(4)), they are nonetheless part of a plan separate from the section 401(k) plan for purposes of section 401(a)(4) and 410(b) testing.

These 1994 Amendments incorporate the term "section 401(k) plan" (defined as described above) into several provisions of the 1991 Final Regulations. This is to reflect the requirement (which is unchanged by the 1994 Amendments) for separate testing of QNECs under sections 401(a)(4) and 410(b). Except in the few places in these regulations where the term "section 401(k) plan" has been used, the regulations continue to use the existing term "cash or deferred arrangement" or "CODA" with its current meaning. Thus, incorporation of the term "section 401(k) plan" in selected provisions of the 1994 Amendments does not affect the testing requirements for qualified CODAs, including the two special nondiscrimination testing rules for QNECs in § 1.401(k)–1(b)(5) (i) and (ii).

Under the first of these tests, the QNECs used in the ADP test are aggregated with other nonelective contributions as they would be if they had not been used in the ADP test. In accordance with the final regulations under section 410(b), permitted disparity under section 401(l) may be used to demonstrate that these plan contributions satisfy section 401(a)(4). Under the second test, only those QNECs that are *not* used in the ADP and actual contribution percentage (ACP) tests are taken into account, together

with other nonelective contributions, in determining whether section 401(a)(4) is satisfied. Here too permitted disparity may be used.

A similar term, "section 401(m) plan," has been added by the 1994 Amendments to reflect that QNECs used to pass the ACP test are part of a separate plan for purposes of the nondiscrimination testing required under sections 401(a)(4) and 410(b). Incorporation of the term "section 401(m) plan" does not affect the testing requirements governing employee and matching contributions, including the two special nondiscrimination testing rules in § 1.401(m)–1(b)(5) (i) and (ii) for QNECs used in the ACP test. These testing rules are similar to the special testing rules which apply to QNECs that are used in the ADP test. Thus under the first test, the QNECs used in the ACP test must be tested under section 401(a)(4) by aggregating them with other nonelective contributions. Under the second test, only those QNECs that are not used in the ACP and ADP tests are taken into account, together with other nonelective contributions, for section 401(a)(4) testing purposes. Permitted disparity may also be used under both tests.

As an additional matter, the 1994 Amendments specifically state the rule implicit in the 1991 Final Regulations that the same QNECs may not be used to satisfy both the ADP and the ACP tests. See § 1.401(m)–1(b)(4)(ii)(B).

*4. Plans Benefiting Otherwise Excludable Employees*

Final regulations under section 410(b) permit separate testing of the portion of a plan benefiting employees who have not satisfied the greatest minimum age and service requirements permitted under section 410(a). See § 1.410(b)–6(b)(3). The 1994 Amendments make clear that a plan may separately test these employees under section 401 (k) or (m) without violating the 1991 Final Regulations' prohibition on restructuring, because this separate testing does not constitute restructuring within the meaning of the section 401(a)(4) regulations. Thus, an employer may treat a plan that benefits employees including otherwise excludable employees as two separate plans (one for the otherwise excludable employees and one for all other eligible employees) for purposes of sections 401 (k) and (m) and 410(b). See §§ 1.401(k)–1(b)(3)(ii) and 1.401(m)–1(b)(3)(ii).

*5. Retroactive Correction of Certain Defects*

The 1994 Amendments add references to § 1.401(a)(4)– 11(g)(3)(vii), which allows retroactive correction of certain prohibited discrimination in section 401 (k) and (m) plans. Section 1.401(a)(4)–11(g)(3)(vii)(A) permits the sponsor of a section 401(k) or 401(m) plan to amend the plan retroactively to satisfy the section 410(b) minimum coverage requirements by allocating QNECs to nonhighly compensated employees who were not eligible under the plan. Section 1.401(a)(4)–11(g)(3)(vii)(B) permits a plan to allocate QNECs to nonhighly compensated employees pursuant to a retroactive amendment in order to satisfy the nondiscriminatory current availability requirement of § 1.401(a)(4)–4(b) with respect to the right to a rate of matching contributions. Since the amount of the added QNECs is based on the ADP or ACP of the group of nonhighly compensated employees who were eligible before the correction, the addition of these QNECs does not change the calculation of the ADP or ACP or the plan's compliance with the ADP or ACP requirements.

Consistent with the limitations contained in the retroactive correction provisions of § 1.401(a)(4)–11(g), the 1994 Amendments affirm that this section 401(a)(4) retroactive correction method cannot be used to correct excess contributions (amounts that exceed the limits under section 401(k)) or excess aggregate contributions (amounts that exceed the limits under section 401(m)). These contributions may be corrected only in accordance with § 1.401(k)–1(f)(1)(iii) or 1.401(m)–1(e)(1)(iii), respectively. Similarly, excess deferrals (amounts that exceed the limits under section 402(g)) may be corrected only in accordance with § 1.402(g)–1(e).

*6. Distributions Upon Plan Termination*

Sections 401(k)(2)(B)(i)(II) and 401(k)(10)(A)(i) permit distributions from a qualified CODA after termination of the plan without the establishment or maintenance of a successor plan by the employer. Section 1.401(k)–1(d)(3) provides that if fewer than two percent of the employees who were eligible under the terminated defined contribution plan that included the CODA are eligible under another plan of the employer during a specified 24-month period, the other plan is not a successor plan. The 1994 Amendments clarify that the number of employees who were eligible under the terminated plan and the identity of the employer are determined as of the date of plan termination. See Rev. Rul. 89–87, 1989–2 C.B. 81, regarding the date of plan termination. Thus, for example, if a plan is terminated as of December 31, 1994, and the plan assets are timely distributed thereafter, then the number of employees who were eligible under the plan is determined as of December 31, 1994. The clarifications of the language relating to these successor plan rules, including the two percent test, are not intended to change the rules governing that test in any way.

*7. Other Benefits Not Contingent Upon Elective Contributions*

Section 401(k)(4)(A) and § 1.401(k)–1(e)(6) of the 1991 Final Regulations provide that a CODA is a qualified CODA only if no other benefit (other than a matching contribution under section 401(m)) is conditioned (directly or indirectly) upon the employee's electing to make or not to make elective contributions. The 1994 Amendments add two examples to § 1.401(k)–1(e)(6) to respond to frequent questions concerning the application of the contingent benefit rule to two specific arrangements involving relationships between a nonqualified deferred compensation plan and a qualified CODA. These examples illustrate the existing rules, and are not intended to change those rules in any way.

*8. Coordination of Excess Deferrals With Excess Contributions*

The 1994 Amendments amend *Example 2* in § 1.402(g)–1(e)(11) to reflect more accurately the rules that coordinate the correction of excess deferrals and excess contributions. Under these rules, excess deferrals that have been distributed to a highly compensated employee serve the purpose of reducing the amount to be distributed as an excess deferral and excess contribution. See §§ 1.401(k)–1(f)(5); 1.402(g)–1(e)(1)(ii). Conversely, excess contributions that have been distributed to a highly compensated employee reduce both the excess contribution and the amount to be distributed as an excess deferral. See §§ 1.401(k)–1(f)(5); 1.402(g)–1(e)(6). The statement in *Example 2* that further correction was required to pass the ADP test under the facts of the example was inaccurate and has been deleted.

*9. Distribution of Matching Contributions Related to Excess Deferrals, Excess Contributions, and Excess Aggregate Contributions*

Questions have been raised about the extent to which a matching contribution may be distributed if it relates to an amount that is distributed as an excess contribution, excess deferral, or excess aggregate contribution. Distribution of excess deferrals, excess contributions, or excess aggregate contributions may cause matching contributions related to the distributed amounts to be

discriminatory by producing an effective rate of match that discriminates in favor of highly compensated employees. See § 1.401(a)(4)–4(e)(3)(G).

There are two circumstances under which a matching contribution may be distributed. First, it may be distributed if it is an excess aggregate contribution. In this case, the matching contribution will not be taken into account under section 401(a)(4). Thus, it will not be considered in determining whether there is a discriminatory rate of match. Second, the matching contribution may be distributed on some other permissible basis under the general plan qualification rules applicable to the type of plan under which the matching contribution was made, e.g., attainment of age 59½ under a profit-sharing or stock bonus plan. However, in that case, the amount contributed would still be taken into account under section 401(a)(4), and therefore the distribution, even if timely made, would not correct any failure to satisfy a nondiscrimination requirement, including a discriminatory rate of match. Section 1.401(m)–1(e)(4) has been amended to make this explicit. The 1994 Amendments also explicitly state that a matching contribution may not be distributed simply because it relates to an excess deferral, an excess contribution, or an excess aggregate contribution that is distributed. See § 1.401(m)–1(e)(3)(vii).

Where a matching contribution relates to an excess deferral, an excess contribution, or an excess aggregate contribution that is distributed, a discriminatory rate of match may result, unless the matching contribution is distributed as an excess aggregate contribution. If the matching contribution cannot be distributed as an excess aggregate contribution, so that the discriminatory rate of match cannot be corrected by distribution, a plan may provide that the matching contributions are forfeited, as permitted by sections 411(a)(3)(G) and 401(k)(8)(E). See §§ 1.401(k)–1(f)(5)(iii); 1.401(m)–1(e)(4); 1.411(a)–4(b)(7). Alternatively, the discriminatory rate of match can be corrected by additional allocations to the accounts of nonhighly compensated employees, under § 1.401(a)(4)–11(g)(3)(vii)(B).

*10. Multiple Use Test*

The 1991 Final Regulations, as amended by the 1994 Amendments, continue to provide that if any highly compensated employee is eligible to participate in both a section 401(k) plan and a section 401(m) plan of an employer, the plans must satisfy the limitation on multiple use of the alternative methods of compliance with the ADP and ACP tests (the 200%/two-percentage-point method, as opposed to the 125% method) that are contained in sections 401(k)(3)(A)(ii)(II) and 401(m)(2)(A)(ii), respectively. Language has been added to § 1.401(m)–1(a)(1) to clarify that if the plans fail to satisfy the multiple use limitation in operation, and the failure is not corrected as permitted by § 1.401(m)–2(c), the section 401(m) plan fails to satisfy section 401 (a)(4) and (m).

An additional clarification in the multiple use rules has been added to § 1.401(m)–2(c)(1). The 1991 Final Regulations provide that multiple use may be corrected by reducing either the ADP or the ACP of the highly compensated employees. The 1994 Amendments clarify that multiple use may also be corrected by reducing a combination of the ADP and the ACP of the highly compensated employees.

*11. Safe Harbor Hardship Withdrawal Provisions*

In response to suggestions, the 1994 Amendments expand the safe harbor hardship withdrawal provisions to provide that, in addition to tuition and related educational fees, amounts distributed for the payment of room and board expenses for the next 12 months of post-secondary education will be deemed to be on account of an immediate and heavy financial need. See § 1.401(k)–1(d)(2)(iv)(A)(3).

*12. Hardship Distributions Under Profit-Sharing or Stock Bonus Plans*

The 1991 Final Regulations added § 1.411(d)–4, Q&A–2(b)(2)(x) to make an exception to the protections of section 411(d)(6) and allow a qualified CODA that permits hardship distributions to be amended to specify or modify its standards for making such distributions, or to eliminate hardship distributions. In response to suggestions, the 1994 Amendments now amend this section to allow the same flexibility to any profit-sharing or stock bonus plan that permits hardship distributions. Under this amendment, a profit-sharing or stock bonus plan has this flexibility whether or not the plan limits hardship distributions (either before or after the plan amendment) to the types of hardship distributions that are permitted to be made from a qualified CODA. Hardship distributions under a portion of the plan that is a qualified CODA must be restricted in accordance with section 401(k) and the regulations.

*13. Excise Tax Transition Relief for Collectively Bargained and Governmental Plans*

In accordance with the applicable provisions of the Code, the 1991 Final Regulations provide that elective contributions under a CODA that is part of a collectively bargained plan and that fails the ADP test are includible in employees' gross incomes because the CODA is not qualified. The 1991 Final Regulations provided transition relief by not making this income inclusion effective for plan years beginning before January 1, 1993.

The question has arisen whether this transition relief from income inclusion for collectively bargained plans would be expanded to cover the section 4979 excise tax on excess contributions. The 1994 Amendments respond by amending § 54.4979–1(d)(3) to provide that the excise tax does not apply to a collectively bargained plan for plan years beginning before January 1, 1993. Thus, for these plan years, a collectively bargained plan need not perform the ADP test for any purpose. Furthermore, the 1994 Amendments explicitly provide that the excise tax does not apply to employee and matching contributions under a collectively bargained plan.

For governmental plans, the nondiscrimination rules, including the nondiscrimination requirements under sections 401(k) and 401(m), generally do not apply for plan years beginning before January 1, 1996. The proposed amendments to the 1991 Final Regulations reflected this extended effective date. The 1994 Amendments adopt the proposed amendments and also apply the same extended effective date to the section 4979 excise tax.

*14. One-Time Irrevocable Elections*

The 1991 Final Regulations provide that an employer may allow each of its employees to make a one-time irrevocable election, upon commencement of employment or initial eligibility under any plan of the employer, to have a specified amount or percentage of compensation (including no amount) contributed by the employer throughout the employee's employment. This type of election is not treated as a cash or deferred election. See § 1.401(k)–1(a)(3)(iv).

The question has occasionally been raised as to whether such an election could conceivably be made by an employee upon first becoming eligible under a plan even though the employee had previously become eligible under any other ongoing or terminated plan of the employer. The 1994 Amendments

make clear that the answer to this question is in the negative. They confirm that the one-time irrevocable election provision was intended to preclude an election from constituting a non-cash-or-deferred election (and thus avoiding the rules governing qualified CODAs) in any case where the electing employee had previously become eligible under another plan of the employer, including a terminated plan, even if the employee is making an election with respect to a plan under which the employee is just then becoming eligible. Thus, an employee can make an election under § 1.401(k)–1(a)(3)(iv) only once during employment with a particular employer (even if, over time, the employee becomes eligible under more than one plan of the employer). This election can be made either (1) upon commencement of employment with the employer, or (2) upon becoming eligible under the plan of the employer under which the employee becomes eligible first.

The 1991 Final Regulations reiterated a special, additional, one-time election transition rule for plans maintained by partnerships. See § 1.401(k)–1(a)(6)(ii)(C). This transition relief originally had been provided for under Notice 88–127, 1988–2 C.B. 538. See also Rev. Proc. 91–47, 1991–2 C.B. 757. As an alternative to compliance by a plan with the qualified CODA rules, the transition rule was intended to give existing partnership plans a limited period of time (until the later of the first day of the first plan year beginning after December 31, 1988, or March 31, 1989) for employees and partners to make one-time irrevocable elections, even after their commencement of employment or their initial eligibility under the plan or any other plan of the employer. However, occasional questions have been raised since 1989 as to whether this could nonetheless be interpreted as a continuing transition rule for partnerships that might permit such one-time irrevocable elections to be made in the future. The 1994 Amendments explicitly confirm that such elections under the special partnership transition rule may not be made in the future. A partnership may, of course, continue to allow partners and employees to make one-time irrevocable elections under the general rule of § 1.401(k)–1(a)(3)(iv) in the same limited circumstances as any other employer.

*15. Limit on Annual Additions*

a. Corrective Distribution of Elective Deferrals

The 1991 Final Regulations amended § 1.415–6(b)(6) to allow plans to distribute elective deferrals to correct excess annual additions resulting from a reasonable error in determining the amount of elective deferrals that a participant may make under the limits of section 415. A question has arisen as to whether gains (investment gains and other income) attributable to the distributed elective deferrals are treated for section 415 purposes in a manner similar to gains attributable to employee contributions that are returned pursuant to § 1.415–6(b)(6) (which have been explicitly addressed in that regulation since before 1991). The 1994 Amendments make clear that similar treatment is intended, by providing that if gains attributable to the distributed elective deferrals are not also distributed to the employee, the gains will be considered as employer contributions for the limitation year in which the distributed elective deferrals were made. This provision of the 1994 Amendments is effective for limitation years beginning after December 31, 1995.

b. Plan Amendments Reducing Accrued Benefits to Comply With Tax Reform Act of 1986

The Tax Reform Act of 1986 (TRA '86) generally reduced the amount of benefits that could be provided by a defined benefit plan under the section 415 benefit limitations. The changes generally were effective for limitation years beginning after December 31, 1986. However, section 1106(i)(3) of TRA '86 protected the "current accrued benefit" of an individual who was a participant in a defined benefit plan meeting certain requirements. The "current accrued benefit" was defined as the benefit that accrued before the effective date, not including any benefits under new plans or any benefits resulting from changes in existing plans after May 5, 1986. These additional accruals generally caused plan disqualification when the new limits applied. Notice 87–21, 1987–1 C.B. 458, Q&A–13, illustrated this effect and stated that future regulations would provide section 411(d)(6) relief allowing defined benefit plans to reduce accrued benefits that otherwise would violate the applicable limit. This relief would create an exception to the general section 411(d)(6) prohibition against plan amendments reducing accrued benefits.

Q&A–17 of Notice 87–21 illustrated that these additional accruals could also result in a violation of the combined limit on contributions and benefits under section 415(e). The combined limit applies to participants covered by both a defined benefit plan and a defined contribution plan. Such a violation could occur even if the defined benefit plan was terminated before the effective date of the section 415 changes, and even if no contributions were made to the defined contribution plan after the effective date.

The 1991 Final Regulations added § 1.411(d)–4, Q&A–2(b)(2)(xi) to permit a defined benefit plan to reduce benefits that otherwise would violate the lower section 415(b) limit under TRA '86. These 1994 Amendments now expand this relief by allowing a reduction in benefits under either a defined benefit plan or a defined contribution plan to satisfy the combined limit under section 415(e), which also was reduced as a result of the changes made by TRA '86. This amendment to § 1.411(d)–4, Q&A–2(b)(2)(xi), will also allow a defined contribution plan to reduce a participant's account balance where the defined benefit plan has been terminated and thus can no longer be amended to reduce the participant's benefits. See also § 1.415–6(b)(6), providing methods for correcting excess annual additions to defined contribution plans in certain circumstances.

**Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 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) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f)(3) of the Internal Revenue Code, these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

**Drafting Information**

The principal author of these regulations is Catherine Livingston Fernandez, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations), IRS. However, personnel from other offices of the IRS and Treasury Department participated in their development.

**List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

**Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

## PART 1—INCOME TAXES

**Paragraph 1.** The authority citation for part 1 continues to read, in part, as follows:

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

**Par. 2.** Section 1.401(k)–0 is amended as follows:

1. The entries for § 1.401(k)–1, paragraph (b)(3) and (b)(3)(i) and (ii) are revised.
2. The entries for § 1.401(k)–1, paragraph (b)(3)(ii)(A) and (B), and (b)(3)(iii) and (iv) are removed.
3. The entry for § 1.401(k)–1 paragraph (b)(4)(ii) is revised.
4. An entry for § 1.401(k)–1, paragraph (e)(6)(vi) is added.
5. The entries for § 1.401(k)–1, paragraph (g)(11)(i) and (ii) are revised.
6. Entries for § 1.401(k)–1, paragraphs (g)(11)(ii)(A) through (C) are added.
7. The entries for § 1.401(k)–1, paragraphs (g)(11)(iii), (g)(11)(iii)(A) through (D), (g)(11)(iii)(D)(*1*) and (*2*), and (g)(11)(iv) are removed.
8. Entries for § 1.401(k)–1, paragraph (g)(15) and (16) are added.
9. The entry for § 1.401(k)–1, paragraph (h)(4)(ii) is revised.

The added and revised entries read as follows:

**§ 1.401(k)–0 Certain cash or deferred arrangements, table of contents.**

* * * * *

*§ 1.401(k)–1* * * *

* * * * *

(b) * * *

(3) Aggregation.

(i) Aggregation of arrangements and plans.

(ii) Restructuring and Permissive Aggregation.

(4) * * *

(ii) Elective contributions and qualified nonelective contributions used to satisfy actual contribution percentage test.

* * * * *

(e) * * *

(6) * * *

(vi) Examples.

* * * * *

(g) * * *

(11) * * *

(i) Application of section 410(b) rules.

(ii) Modifications to section 410(b) rules.

(A) In general.

(B) Plans benefiting collective bargaining unit employees.

(C) Multiemployer plans.

* * * * *

(15) Section 401(k) plan.

(16) Section 401(m) plan.

(h) * * *

(4) * * *

(ii) Plan years beginning before January 1, 1996.

* * * * *

**Par. 3.** Section 1.401(k)–1 is amended as follows:

1. Paragraph (a) is amended as follows:

i. Paragraph (a)(3)(iv) is amended by adding a sentence immediately before the last sentence.

ii. Paragraph (a)(3)(v) is revised.

iii. Paragraph (a)(3)(vi), *Example 3*, is added.

iv. Paragraphs (a)(4)(ii) and (iv), (a)(5)(iv), (a)(6)(ii)(C), and (a)(7)(i) are revised.

2. Paragraph (b) is amended as follows:

i. Paragraphs (b)(1)(i), (ii), and (b)(3) are revised.

ii. Paragraph (b)(4)(ii) heading is revised and a sentence is added at the end of the paragraph.

iii. Paragraphs (b)(4)(iv), (b)(5)(i) and (ii) are amended by adding a sentence at the end of each paragraph.

iv. Paragraph (b)(5)(vi) is revised.

v. Paragraph (b)(6) is amended by:

a. Revising *Example 2*, paragraph (i).

b. Revising *Example 3*, paragraph (i).

c. Revising *Example 4*, paragraph (i).

3. Paragraph (d) is amended as follows:

i. Paragraphs (d)(2)(iv)(A)(*3*), (d)(3), and (d)(4)(i) are revised.

ii. The last sentence of paragraph (d)(5) is revised.

iii. A sentence is added at the end of paragraph (d)(6)(iv).

4. Paragraph (e) is amended as follows:

i. A sentence is added at the end of paragraph (e)(6)(ii).

ii. Paragraph (e)(6)(vi) is added.

iii. Paragraph (e)(7) is revised.

5. Paragraph (f) is amended as follows:

i. Paragraphs (f)(1)(iii), (f)(2), (f)(3)(ii), and (f)(3)(iii)(C) are revised.

ii. In paragraph (f)(3)(v), paragraph (i) of the *Example* is revised.

iii. Paragraph (f)(4)(ii)(B) is revised.

iv. Paragraph (f)(7), paragraph (i) of *Example 1*, and *Examples 2* and *3* are revised.

6. Paragraph (g) is amended as follows:

i. Paragraphs (g)(1)(ii)(B)(*1*) and (C)(*1*), and (g)(2)(i) are revised.

ii. A sentence is added at the end of paragraph (g)(4)(ii).

iii. Paragraphs (g)(5), (6) and (11) are revised.

iv. Paragraphs (g)(15) and (16) are added.

7. Paragraphs (h)(3)(iii) (A) and (B)(2), and (h)(4)(ii) are revised.

The added and revised provisions read as follows:

**§ 1.401(k)–1 Certain cash or deferred arrangements.**

(a) * * *

(3) * * *

(iv) * * * In no event is an election made after December 23, 1994 treated as one-time irrevocable election under this paragraph if the election is made by an employee who previously became eligible under another plan (whether or not terminated) of the employer. * * *

(v) *Tax treatment of employees.* An amount generally is includible in an employee's gross income for the taxable year in which the employee actually or constructively receives the amount. But for section 402(e)(3) and section 401(k), an employee is treated as having received an amount that is contributed to a plan pursuant to the employee's cash or deferred election. This is the case even if the election to defer is made before the year in which the amount is earned, or before the amount is currently available. See § 1.402(a)–1(d).

(vi) * * *

* * * * *

*Example 3.* (i) Employer A establishes a qualified money purchase pension plan in 1986. This is the first qualified plan established by Employer A. All salaried employees are eligible to participate under the plan. Hourly-paid employees are not eligible to participate under the plan. In 1996, Employer A establishes a profit-sharing plan under which all employees (both salaried and hourly) are eligible. Employer A permits all employees on the effective date of the profit-sharing plan to make a one-time irrevocable election to have Employer A contribute five percent of compensation on their behalf to the plan and to any other plan of Employer A (including plans not yet established) for the duration of the employee's employment with Employer A, and have their salaries reduced by five percent.

(ii) The election provided under the profit-sharing plan is not a one-time irrevocable election within the meaning of § 1.401(k)–1(a)(3)(iv) with respect to the salaried employees of Employer A who, at any time before becoming eligible to participate under the profit-sharing plan, became eligible to participate under the money purchase pension plan. The election under the profit-sharing plan is a one-time irrevocable election within the meaning of § 1.401(k)–1(a)(3)(iv) with respect to the hourly employees, because they were not previously eligible to participate under another plan of the employer.

(4) * * *

(ii) *Treatment of elective contributions as employer contributions.* Except as provided in paragraph (f) of this section, elective contributions

under a qualified cash or deferred arrangement are treated as employer contributions. Thus, for example, elective contributions are treated as employer contributions for purposes of sections 401(a) and 401(k), 402, 404, 409, 411, 412, 415, 416, and 417.

* * * * *

(iv) *Application of nondiscrimination requirements to plan that includes a qualified cash or deferred arrangement.* A plan that includes a qualified cash or deferred arrangement must satisfy the requirements of sections 401(a)(4) and 410(b). Thus, for example, the plan must satisfy section 401(a)(4) with respect to the amount of contributions or benefits and the availability of benefits, rights and features under the plan. See § 1.401(a)(4)–1(b)(3). The right to make each level of elective contributions under a cash or deferred arrangement is a benefit, right or feature subject to this requirement, and each of these rights must therefore generally be available to a group of employees that satisfies section 410(b). See § 1.401(a)(4)–4(e)(3)(i) and (iii)(D). Thus, for example, if all employees are eligible to make a stated level of elective contributions under a cash or deferred arrangement, but that level of contributions can only be made from compensation in excess of a stated amount, such as the Social Security taxable wage base, the arrangement will generally favor highly compensated employees with respect to the availability of elective contributions and thus will generally not satisfy the requirements of section 401(a)(4). For plan years beginning after December 31, 1984, the amount of elective contributions under a qualified cash or deferred arrangement satisfies the requirements of section 401(a)(4) only if the amount of elective contributions satisfies the special nondiscrimination test of section 401(k)(3) and paragraph (b)(2) of this section. See § 1.401(a)(4)–1(b)(2)(ii)(B). See also § 1.401(a)(4)–11(g)(3)(vii)(A), relating to corrective amendments that may be made to satisfy the minimum coverage requirements of section 410(b).

(5) * * *

(iv) *Qualification of plan that includes a nonqualified cash or deferred arrangement.* A profit-sharing, stock bonus, pre-ERISA money purchase pension, or rural cooperative plan does not fail to satisfy the requirements of section 401(a) merely because the plan includes a nonqualified cash or deferred arrangement. In determining whether the plan satisfies the requirements of section 401(a)(4), the special nondiscrimination tests of sections 401(k)(3) and 401(m)(2) may not be used. See §§ 1.401(a)(4)–1(b)(2)(ii)(B) and 1.410(b)–9 (definition of section 401(k) plan).

(6) * * *

(ii) * * *

(C) *Transition rule for partnership cash or deferred elections.* A one-time irrevocable election to participate or not to participate in a plan in which partners may participate is not a cash or deferred election if the election was made on or before the later of the first day of the first plan year beginning after December 31, 1988, or March 31, 1989. This election may be made after the commencement of employment or after the employee's first becoming eligible under any plan of the employer. In no event, however, may the election be made after December 23, 1994. The election may be made even if the one-time irrevocable election in § 1.401(k)–1(a)(3)(iv) was previously made.

* * * * *

(7) * * * (i) *In general.* The amount of employer contributions under a nonqualified cash or deferred arrangement is treated as satisfying section 401(a)(4) if the arrangement is part of a collectively bargained plan (including a plan adopted by a state or local government before May 6, 1986) that automatically satisfies the requirements of section 410(b). See §§ 1.401(a)(4)–1(c)(5) and 1.410(b)–2(b)(7). Except as specifically provided otherwise, elective contributions under the arrangement are treated as employer contributions. See § 1.401(k)–1(a)(5)(ii). However, elective contributions under the nonqualified cash or deferred arrangement are treated as employee contributions for purposes of section 402(a) for plan years beginning after December 31, 1992, and are therefore not excludable from gross income under section 402(e)(3). See § 1.402(a)–1(d)(3)(iv).

* * * * *

(b) * * *

(1) * * *

(i) The group of eligible employees under the section 401(k) plan and the group of employees benefiting under the plan to which the nonelective employer contributions are made separately satisfy the requirements of section 410(b) (including the average benefit percentage test, if applicable). For special rules governing the application of section 410(b) to a cash or deferred arrangement, see §§ 1.410(b)–7(c)(1) and 1.410(b)–8(a)(1). See also § 1.401(a)(4)–11(g)(3)(vii)(A), relating to corrective amendments that may be made to satisfy the minimum coverage requirements of section 410(b).

(ii) The cash or deferred arrangement satisfies the actual deferral percentage test described in paragraph (b)(2) of this section. This is the exclusive nondiscrimination test applicable to the amount of elective contributions under a qualified cash or deferred arrangement. See § 1.401(a)(4)–1(b)(2)(ii)(B).

* * * * *

(3) *Aggregation*—(i) *Aggregation of arrangements and plans.* Except as otherwise specifically provided in this paragraph (b)(3), all cash or deferred arrangements included in a plan are treated as a single cash or deferred arrangement. Thus, for example, if two groups of employees are eligible for separate cash or deferred arrangements under the same plan, the two cash or deferred arrangements are treated as a single cash or deferred arrangement, even if they have significantly different features, such as significantly different limits on elective contributions. See § 1.401(k)–1(g)(11) for the definition of plan used for purposes of this section. That definition contains the exclusive rules for aggregation and disaggregation of plans for purposes of this section. See also paragraph (g)(1)(ii) of this section for rules requiring the aggregation of elective contributions under two or more plans in computing the actual deferral ratios of certain employees.

(ii) *Restructuring and Permissive Aggregation.* Effective for plan years beginning after December 31, 1991, restructuring under § 1.401(a)(4)–9(c) may not be used to demonstrate compliance with the requirements of section 401(k). See § 1.401(a)(4)–9(c)(3)(ii). For plan years beginning before January 1, 1992, see § 1.401(k)–1(h)(3)(iii). An employer may, however, treat a plan benefiting otherwise excludable employees as two separate plans for purposes of sections 401(k) and 410(b) in accordance with §§ 1.410(b)–6(b)(3) and 1.410(b)–7(c)(3).

(4) * * *

(ii) *Elective contributions and qualified nonelective contributions used to satisfy actual contribution percentage test.* * * * A qualified nonelective contribution that is treated as a matching contribution is subject to the actual contribution percentage test of section 401(m)(2) and is not taken into account as an elective contribution under paragraph (b)(2) or (5) of this section.

* * * * *

(iv) * * * See §§ 1.401(a)(4)–1(b)(2)(ii)(B); 1.410(b)–7(c)(1).

(5) * * *

(i) * * * See § 1.401(a)(4)–1(b)(2).

(ii) * * * See § 1.401(a)(4)–1(b)(2).

* * * * *

(vi) For plan years beginning after December 31, 1988, or such later date provided in paragraph (h) of this section, the section 401(k) plan and the plan or plans to which the qualified nonelective contributions and qualified matching contributions are made, could be aggregated under § 1.410(b)–7(d) after application of the mandatory disaggregation rules of § 1.410(b)–7(c), as modified in § 1.401(k)–1(g)(11). If the plan year of the section 401(k) plan is changed to satisfy the requirement under § 1.410(b)–7(d)(5) that aggregated plans have the same plan year, the qualified nonelective contributions and qualified matching contributions may be taken into account in the resulting short plan year only if the contributions satisfy the requirements of paragraph (b)(4)(i) of this section with respect to the short year as if the contributions were elective contributions and the aggregated plans could otherwise be aggregated for purposes of section 410(b).

(6) * * *

* * * * *

*Example 2.* (i) The facts are the same as in *Example 1*, except that elective contributions are made pursuant to a salary reduction agreement and no bonuses are paid. Employer X includes elective contributions in compensation as permitted under § 1.414(s)–1(c)(4)(i). See § 1.401(k)–1(g)(2)(i). In addition, A defers $2,025. Thus, the compensation and elective contributions for A, B, and C are:

| Employee | Compensation | Elective contributions | Actual deferral ratio (percent) |
|---|---|---|---|
| A | $30,000 | $2,025 | 6.75 |
| B | 15,000 | 750 | 5.00 |
| C | 10,000 | 450 | 4.50 |

* * * * *

*Example 3.* (i) Employees D through L are eligible employees in Employer A's profit-sharing plan that contains a cash or deferred arrangement. Employer A includes elective contributions in compensation as permitted under § 1.414(s)–1(c)(4)(i). Each eligible employee may elect to defer up to six percent of compensation under the cash or deferred arrangement. Employees D and E are highly compensated. The compensation, elective contributions, and actual deferral ratios of these employees for the 1989 plan year are shown below:

| Employee | Compensation | Elective contributions | Actual deferral ratio (percent) |
|---|---|---|---|
| D | $100,000 | $6,000 | 6 |
| E | 80,000 | 4,000 | 5 |
| F | 60,000 | 3,600 | 6 |
| G | 40,000 | 1,600 | 4 |
| H | 30,000 | 1,200 | 4 |
| I | 20,000 | 600 | 3 |
| J | 20,000 | 600 | 3 |
| K | 10,000 | 300 | 3 |
| L | 5,000 | 150 | 3 |

* * * * *

*Example 4.* (i) Employer D maintains a profit-sharing plan that contains a cash or deferred arrangement. Employer D includes elective contributions in compensation as permitted under § 1.414(s)–1(c)(4)(i). The following amounts are contributed under the plan:

* * * * *

(d) * * *

(2) * * *

(iv) * * *

(A) * * *

(*3*) Payment of tuition, related educational fees, and room and board expenses, for the next 12 months of post-secondary education for the employee, or the employee's spouse, children, or dependents (as defined in section 152); or

* * * * *

(3) *Rules applicable to distributions upon plan termination.* A distribution may not be made under paragraph (d)(1)(iii) of this section if the employer establishes or maintains a successor plan. For purposes of this rule, the definition of the term "employer" contained in paragraph (g)(6) of this section is applied as of the date of plan termination, and a successor plan is any other defined contribution plan maintained by the same employer. However, if at all times during the 24-month period beginning 12 months before the termination, fewer than two percent of the employees who were eligible under the defined contribution plan that includes the cash or deferred arrangement as of the date of plan termination are eligible under the other defined contribution plan, the other plan is not a successor plan. The term "defined contribution plan" means a plan that is a defined contribution plan as defined in section 414(i), but does not include an employee stock ownership plan as defined in section 4975(e) or 409(a) or a simplified employee pension as defined in section 408(k). A plan is a successor plan only if it exists at any time during the period beginning on the date of plan termination and ending 12 months after distribution of all assets from the terminated plan.

(4) * * * (i) *Seller must maintain the plan.* A distribution may be made under section 401(k)(10) and paragraph (d)(1)(iv) or (v) of this section only from a plan that the seller continues to maintain after the disposition. This requirement is satisfied if and only if the purchaser does not maintain the plan after the disposition. A purchaser maintains the plan of the seller if it adopts the plan or otherwise becomes an employer whose employees accrue benefits under the plan. A purchaser also maintains the plan if the plan is merged or consolidated with, or any assets or liabilities are transferred from the plan to a plan maintained by the purchaser in a transaction subject to section 414(*l*)(1). A purchaser is not treated as maintaining the plan merely because a plan that it maintains accepts elective transfers described in § 1.411(d)–4, Q&A–3(b)(1), or rollover contributions of amounts distributed by the plan (including distributions that the recipient elects, under section

401(a)(31), to have paid in a direct rollover to the plan of the purchaser).

* * * * *

(5) * * * The term *lump sum distribution* has the meaning provided in section 402(d)(4), without regard to subparagraphs (A) (i) through (iv), (B), and (F) of that section.

(6) * * *

(iv) * * * The limitations of paragraph (d) of this section also do not apply to amounts distributed from another plan that the recipient elects under section 401(a)(31) to have paid in a direct rollover to the plan.

* * * * *

(e) * * *

(6) * * *

(ii) * * * Benefits under any other plan or arrangement (whether or not qualified) are not contingent upon an employee's electing to make or not to make elective contributions under a cash or deferred arrangement merely because the elective contributions are or are not taken into account as compensation under the other plan or arrangement for purposes of determining benefits.

* * * * *

(vi) *Examples.* The provisions of this paragraph (e)(6) are illustrated by the following examples.

*Example 1.* Employer T maintains a cash or deferred arrangement for all of its employees. Employer T also maintains a nonqualified deferred compensation plan for two highly paid executives, Employees R and C. Under the terms of the nonqualified deferred compensation plan, R and C are eligible to participate only if they do not make elective contributions under the cash or deferred arrangement. Participation in the nonqualified plan is a contingent benefit for purposes of this paragraph (e)(6), because R's and C's participation is conditioned on their electing not to make elective contributions under the cash or deferred arrangement.

*Example 2.* Employer T maintains a cash or deferred arrangement for all its employees. Employer T also maintains a nonqualified deferred compensation plan for two highly paid executives, Employees R and C. Under the terms of the arrangements, Employees R and C may defer a maximum of 10 percent of their compensation, and may allocate their deferral between the cash or deferred arrangement and the nonqualified deferred compensation plan in any way they choose (subject to the overall 10 percent maximum). Because the maximum deferral available under the nonqualified deferred compensation plan depends on the elective deferrals made under the cash or deferred arrangement, the right to participate in the nonqualified plan is a contingent benefit for purposes of paragraph (e)(6).

(7) *Coordination with other plans.* For plan years beginning after December 31, 1988, or such later date provided in paragraph (h) of this section, a cash or deferred arrangement satisfies this paragraph (e) only if no elective contributions (or qualified matching contributions treated as elective contributions under paragraph (b)(5) of this section) under the arrangement are taken into account for purposes of determining whether any other contributions under any plan (including the plan to which the elective contributions are made) satisfy the requirements of section 401(a). Indeed, the portion of a plan that consists of elective contributions is treated as a separate plan for purposes of sections 401(a)(4) and 410(b). See § 1.410(b)–7(c)(1). Similarly, elective contributions under a cash or deferred arrangement generally may not be taken into account in determining whether a plan satisfies the minimum contribution or benefit requirements of section 416. See § 1.416–1, M–20. However, qualified nonelective contributions that are treated as elective contributions for purposes of section 401(k)(3) under paragraph (b)(5) of this section may be used to enable a plan to satisfy the minimum contribution or benefit requirements under section 416. See § 1.416–1, M–18. This paragraph (e) does not apply for purposes of determining whether a plan satisfies the average benefit percentage requirement of section 410(b)(2)(A)(ii). See also § 1.401(m)–1(b)(5) for circumstances under which elective contributions may be used to determine whether a plan satisfies the requirements of section 401(m).

* * * * *

(f) * * *

(1) * * *

* * * * *

(iii) *Impermissible correction methods.* Excess contributions for a plan year may not remain unallocated or be allocated to a suspense account for allocation to one or more employees in any future year. In addition, excess contributions may not be corrected using the retroactive correction rules of § 1.401(a)(4)–11(g). See § 1.401(a)(4)–11(g) (3)(vii) and (5). See paragraph (f)(6) of this section for the effects of a failure to correct excess contributions.

(2) *Amount of excess contributions.* The amount of excess contributions for a highly compensated employee for a plan year is the amount (if any) by which the employee's elective contributions must be reduced for the employee's actual deferral ratio to equal the highest permitted actual deferral ratio under the plan. To calculate the highes. permitted actual deferral ratio under a plan, the actual deferral ratio of the highly compensated employee with the highest actual deferral ratio is reduced by the amount required to cause the employee's actual deferral ratio to equal the ratio of the highly compensated employee with the next highest actual deferral ratio. If a lesser reduction would enable the arrangement to satisfy the actual deferral percentage test, only this lesser reduction may be made. This process must be repeated until the cash or deferred arrangement satisfies the actual deferral percentage test. The highest actual deferral ratio remaining under the plan after leveling is the highest permitted actual deferral ratio. Thus, for each highly compensated employee, the amount of excess contributions for a plan year is equal to the employee's elective contributions, plus qualified nonelective contributions and qualified matching contributions taken into account in determining the employee's actual deferral ratio under paragraph (g)(1) of this section, minus the amount determined by multiplying the employee's actual deferral ratio (determined after application of this paragraph (f)(2)) by the compensation used in determining the ratio. In no case may the amount of excess contributions to be recharacterized or distributed for a plan year with respect to any highly compensated employee exceed the amount of elective contributions made on behalf of the highly compensated employee for the plan year.

(3) * * *

(ii) *Treatment of recharacterized excess contributions.*

(A) Excess contributions recharacterized under this paragraph (f)(3) are includable in the employee's gross income on the earliest dates any elective contribution made on behalf of the employee during the plan year would have been received by the employee had the employee originally elected to receive the amounts in cash, or on such later date permitted in paragraph (f)(3)(iv) of this section. The recharacterized excess contributions must be treated as employee contributions for purposes of section 72, section 401(a)(4) and 401(m), and paragraphs (b) and (d) of this section. This requirement is not treated as satisfied unless:

(*1*) The payor or plan administrator reports the recharacterized excess contributions as employee contributions to the Internal Revenue Service and the employee by—

(*i*) Timely providing such forms as the Commissioner may designate to the employer and to employees whose excess contributions are recharacterized under this paragraph (f)(3); and

(*ii*) Timely taking such other action as the Commissioner may require; and

(*2*) The plan administrator accounts for the amounts as contributions by the employee for purposes of sections 72 and 6047.

(B) Recharacterized excess contributions continue to be treated as employer contributions that are elective contributions for all other purposes under the Internal Revenue Code, including sections 401(a) (other than 401(a)(4) and 401(m)), 404, 409, 411, 412, 415, 416, and 417. Thus, for example, recharacterized excess contributions remain subject to the requirements of paragraph (c) of this section; must be deducted under section 404; and are treated as employer contributions described in section 415(c)(2)(A) and § 1.415–6(b). In addition, these amounts are not treated as compensation for purposes of sections 404 and 415, and may be treated as compensation for purposes of sections 401(a)(4), 401(a)(5), 401(k), 401(l) and 414(s) only to the extent that elective contributions may be treated, and are treated under the plan, as compensation. See § 1.414(s)–1(c)(4)(i). Recharacterized excess contributions that relate to plan years ending on or before October 24, 1988, may be treated as either employer contributions or employee contributions for purposes of paragraph (d) of this section. The amount of excess contributions included in an employee's gross income is reduced as provided under paragraph (f)(5)(i)(B) of this section.

(iii) * * *

(C) *Plans under which excess contributions may be recharacterized.* For plan years beginning after December 31, 1991, elective contributions may be recharacterized under this paragraph (f)(3) only under the plan under which they are made or under a plan with which that plan could be aggregated under § 1.410(b)–7(d) after application of the mandatory disaggregation rules of § 410(b)–7(c), as modified in § 1.401(k)–1(g)(11). For plan years beginning before that date and after December 31, 1988, or such later date provided under paragraph (h) of this section, elective contributions may be recharacterized under this paragraph (f)(3) only under the plan under which they are made or under a plan with the same plan year as that plan.

* * * * *

(v) * * *

*Example.* (i) Employer X maintains Plan Y, a calendar year profit-sharing plan that includes a qualified cash or deferred arrangement. Under Plan Y, each eligible employee may elect to defer up to 10 percent of compensation under a salary reduction agreement. An eligible employee may also make employee contributions of up to 10 percent of compensation. X pays the amounts deferred to the trust on the last day of each month. Employer X includes elective contributions in compensation as permitted under § 1.414(s)–1(c)(4)(i). See § 1.401(k)–1(g)(2)(i). Salaries are paid on the same date.

* * * * *

(4) * * *

(ii) * * *

(B) *Method of allocating income.* A plan may use any reasonable method for computing the income allocable to excess contributions, provided that the method does not violate section 401(a)(4), is used consistently for all participants and for all corrective distributions under the plan for the plan year, and is used by the plan for allocating income to participants' accounts. See § 1.401(a)(4)–1(c)(8).

* * * * *

(7) * * *

*Example 1* (i) The Y corporation maintains a cash or deferred arrangement. The plan year is the calendar year For plan year 1989, all 10 of Y's employees are eligible to participate in the cash or deferred arrangement. The Y corporation includes elective contributions in compensation as permitted under § 1.414(s)–1(c)(4)(i). See § 1.401(k)–1(g)(2)(i). The employees' compensation, elective contributions, and actual deferral ratios are shown in the following table:

| Employee | Compensation | Elective contributions | Actual deferral ratio (ADR) (percent |
|---|---|---|---|
| A | $160,000 | $6,400 | 4.0 |
| B | 140,000 | 7,000 | 5.0 |
| C | 70,000 | 7,000 | 10.0 |
| D | 65,000 | 6,500 | 10.0 |
| E | 42,000 | 2,100 | 5.0 |
| F | 35,000 | 3,500 | 10.0 |
| G | 28,000 | 2,800 | 10.0 |
| H | 21,000 | 700 | 3.33 |
| I | 21,000 | 0 | 0 |
| J | 21,000 | 0 | 0 |

* * * * *

*Example 2.* A, B, and C are highly compensated employees of Employer R. Employer R maintains a cash or deferred arrangement. Employer R includes elective contributions in compensation as permitted under § 1.414(s)–1(c)(4)(i). For the plan year 1990, A, B, and C each earns compensation of $100,000 and contributes $7,000 to the plan during the period January through June. B retires in November of 1990 and makes a withdrawal of B's entire account balance of $200,000. In January of 1991, R computes the ADP test for its employees and learns that the highly compensated employees should have contributed only five percent of compensation. Since B made a contribution of $7,000 for 1990, B's contribution and compensation are used in determining the ADP despite the subsequent $200,000 withdrawal. A, B, and C must each receive a corrective distribution of $2,000 in order to meet the ADP test. Since B has already withdrawn B's total account balance under the plan, only A and C must receive a distribution of $2,000 each in order for the plan to meet the ADP test of section 401(k)(3)(A)(ii). Pursuant to the 1990 Form 1099–R Instructions, the plan must issue two Forms 1099–R to B, one reporting the portion of the distribution that was necessary to correct the excess contribution (including income), and one reporting the balance of the distribution. If B had withdrawn less than the total account balance, B would have to withdraw the lesser of $2,000 or the remaining account balance.

*Example 3.* Individual A has a child, B. Both participate in a cash or deferred arrangement maintained by Employer X. A is one of the 10 most highly compensated employees and B is a nonhighly compensated employee. Employer X includes elective contributions in compensation as permitted under § 1.414(s)–1(c)(4)(i). A has compensation of $100,000 and defers $7,000 under the cash or deferred arrangement; B has compensation of $40,000 and defers $4,000 under the arrangement. The actual deferral ratio of the family unit is 7.86 percent, calculated by aggregating the contributions and compensation of A and B ($7,000 + $4,000)/($100,000 + $40,000). For the plan, it is determined that under § 1.401(k)–1(f)(2), the actual deferral ratio of the aggregate family unit must be reduced to

7.20 percent. This reduction is applied in proportion to A's and B's contributions. The excess contributions are $920 ($11,000 total contributions minus $10,080 (7.20% x $140,000)). A's share of the excess contributions is $585.45 ($7,000/$11,000 x $920); B's share is $334.55 ($4,000/$11,000 x $920).

* * * * *

(g) * * *

(1) * * *

(ii) * * *

(B) * * * (*1*) *Highly compensated employees.* For plan years beginning after December 31, 1984, the actual deferral ratio of a highly compensated employee who is eligible to participate in more than one cash or deferred arrangement of the same employer is generally calculated by treating all the cash or deferred arrangements in which the employee is eligible to participate as one arrangement. However, plans that are not permitted to be aggregated under § 1.410(b)–7(c), as modified in paragraph (g)(11) of this section, are not aggregated for this purpose. For example, if a highly compensated employee with compensation of $80,000 could make elective contributions under two separate cash or deferred arrangements, the actual deferral ratio for the employee under each arrangement would generally be calculated by dividing the total elective contributions by the employee under both arrangements by $80,000. If one of the cash or deferred arrangements were part of an ESOP, however, while the other was not, the actual deferral percentage of the employee under each arrangement would be calculated by dividing the employee's elective contributions under each arrangement by $80,000 because the ESOP portion is mandatorily disaggregated from the non-ESOP portion.

* * * * *

(C) * * * (*1*) *Aggregation of elective contributions and other amounts.* For plan years beginning after December 31, 1986, or any later date provided in paragraph (h) of this section, if a highly compensated employee is subject to the family aggregation rules of section 414(q)(6) because that employee is either a five-percent owner or one of the 10 most highly compensated employees, the combined actual deferral ratio for the family group (which is treated as one highly compensated employee) must be determined by combining the elective contributions, compensation, and amounts treated as elective contributions of all family members.

* * * * *

(2) * * * (i) *Years beginning after December 31, 1986.* For plan years beginning after December 31, 1986, or such later date provided in paragraph (h) of this section, the term *compensation* means compensation as defined in section 414(s) and § 1.414(s)–1. The period used to determine an employee's compensation for a plan year must be either the plan year or the calendar year ending within the plan year. Whichever period is selected must be applied uniformly to determine the compensation of every eligible employee under the plan for that plan year for purposes of this section. An employer may, however, limit the period taken into account under either method to that portion of the plan year or calendar year in which the employee was an eligible employee, provided that this limit is applied uniformly to all eligible employees under the plan for the plan year for purposes of this section. See also section 401(a)(17) and § 1.401(a)(17)–1(c)(1).

* * * * *

(4) * * *

(ii) * * * In no event is an election made after December 23, 1994 treated as a one-time irrevocable election under this paragraph if the election is made by an employee who previously became eligible under another plan (whether or not terminated) of the employer.

(5) *Employee.* The term *employee* means an employee within the meaning of § 1.410(b)–9.

(6) *Employer.* The term *employer* means the employer within the meaning of § 1.410(b)–9.

* * * * *

(11) *Plan*—(i) *Application of section 410(b) rules.* The term *plan* means a plan within the meaning of § 1.410(b)–7 (a) and (b), after application of the mandatory disaggregation rules of § 1.410(b)–7(c) and the permissive aggregation rules of § 1.410(b)–7(d), with the modifications provided in paragraph (g)(11)(ii) of this section. Thus, for example, two plans (within the meaning of § 1.410(b)–7(b)) that are treated as a single plan pursuant to the permissive aggregation rules of § 1.410(b)–7(d) are treated as a single plan for purposes of section 401(k). See also § 1.401(k)–1(b)(3)(ii).

(ii) *Modifications to section 410(b) rules*—(A) *In general.* For purposes of this paragraph (g)(11), § 1.410(b)–7 (c) and (d) are applied without regard to § 1.410(b)–7(c)(1), relating to section 401(k) and 401(m) plans.

(B) *Plans benefiting collective bargaining unit employees.* A plan that benefits employees who are included in a unit of employees covered by a collective bargaining agreement and employees who are not included in such a collective bargaining unit is treated as comprising separate plans. This paragraph (g)(11)(ii)(B) is generally applied separately with respect to each collective bargaining unit. At the option of the employer, however, two or more separate collective bargaining units can be treated as a single collective bargaining unit, provided that the combinations of units are determined on a basis that is reasonable and reasonably consistent from year to year. Thus, for example, if a plan benefits employees in three categories—employees included in collective bargaining unit A, employees included in collective bargaining unit B, and employees who are not included in any collective bargaining unit—the plan can be treated as comprising three separate plans, each of which benefits only one category of employees. However, if collective bargaining units A and B are treated as a single collective bargaining unit, the plan will be treated as comprising only two separate plans, one benefiting all employees who are included in a collective bargaining unit and another benefiting all other employees. Similarly, if a plan benefits only employees who are included in collective bargaining unit A and employees who are included in collective bargaining unit B, the plan can be treated as comprising two separate plans. However, if collective bargaining units A and B are treated as a single collective bargaining unit, the plan will be treated as a single plan. An employee is treated as included in a unit of employees covered by a collective bargaining agreement if and only if the employee is a collectively bargained employee within the meaning of § 1.410(b)–6(d)(2).

(C) *Multiemployer plans.* Consistent with section 413(b), the portion of the plan that is maintained pursuant to a collective bargaining agreement (within the meaning of § 1.413–1(a)(2)) is treated as a single plan maintained by a single employer that employs all the employees benefiting under the same benefit computation formula and covered pursuant to that collective bargaining agreement. The rules of paragraph (g)(11)(ii)(B) of this section (including the optional aggregation of collective bargaining units) apply to the resulting deemed single plan in the same manner as they would to a single employer plan, except that the plan administrator is substituted for the employer where appropriate and appropriate fiduciary obligations are taken into account. The noncollectively bargained portion of the plan is treated as maintained by one or more employers, depending on whether the

noncollective bargaining unit employees who benefit under the plan are employed by one or more employers.

* * * * *

(15) *Section 401(k) plan.* The term *section 401(k) plan* means a section 401(k) plan within the meaning of § 1.410(b)–9.

(16) *Section 401(m) plan.* The term *section 401(m) plan* means a section 401(m) plan within the meaning of § 1.410(b)–9.

(h) * * *

(3) * * *

(iii) * * * (A) *General rule.* In determining whether the requirements of section 401(k) are satisfied for plan years beginning before January 1, 1992, a plan may be treated as consisting of two or more component plans, each consisting of all of the allocations and other benefits, rights, and features provided to a group of employees under the plan. See § 1.401(a)(4)–9(c). An employee may not be included in more than one component plan of the same plan for a plan year under this method. If this method is used for a plan year, the requirements of section 401(k) are applied separately with respect to each component plan for the plan year. Thus, for example, the actual deferral ratio and the amount of excess contributions, if any, of each eligible employee under each component plan must be determined as if the component plan were a separate plan. This method applies solely for purposes of section 401(k). Thus, for example, the requirements of section 410(b) must still be satisfied by the entire plan.

(B) * * *

(*2*) *Commonality requirement.* The group of employees used to identify a component plan must share some common attribute or attributes, other than similar actual deferral ratios. Permissible common attributes include, for example, employment at the same work site, in the same job category, for the same division or subsidiary, or for a unit acquired in a specific merger or acquisition, employment for the same number of years, compensation under the same method, *e.g.*, salaried or hourly, coverage under the same contribution formula, and attributes that could be used as the basis of a classification that would be treated as reasonable under § 1.410(b)–4(b). Employees whose only common attribute is the same or similar actual deferral ratios, or another attribute having substantially the same effect as the same or similar actual deferral ratios, are not considered as sharing a common attribute for this purpose. This rule applies regardless of whether the component plan or the plan of which it is a part satisfies the ratio or percentage test of section 410(b).

(4) * * *

(ii) *Plan years beginning before January 1, 1996.* The following rules apply to a governmental plan described in section 414(d) that is not a collectively bargained plan and includes a nonqualified cash or deferred arrangement. These rules apply for plan years beginning before the later of January 1, 1996, or 90 days after the opening of the first legislative session beginning on or after January 1, 1996, of the governing body with authority to amend the plan, if that body does not meet continuously. For purposes of this paragraph (b)(1), the term *governing body with authority to amend the plan* means the legislature, board, commission, council, or other governing body with authority to amend the plan.

* * * * *

**Par. 4.** Section 1.401(m)–0 is amended as follows:

1. The entry for § 1.401(m)–1, paragraph (b)(3)(ii) is removed.

2. The entry for § 1.401(m)–1, paragraph (b)(3)(iii) is revised and redesignated (b)(3)(ii).

3. The entry for § 1.401(m)–1, paragraph (b)(4)(ii)(B) is revised.

4. An entry for § 1.401(m)–1, paragraph (e)(3)(vii) is added.

5. Entries for § 1.401(m)–1, paragraph (f)(16) and (17) are added.

The added and revised entries read as follows:

**§ 1.401(m)–0 Employee and matching contributions, table of contents.**

* * * * *

*§ 1.401(m)–1* * * *

* * * * *

(b) * * *

(3) * * *

(ii) Restructuring and Permissive Disaggregation.

(4) * * *

(ii) * * *

(B) Matching contributions and qualified nonelective contributions used to satisfy actual deferral percentage test.

* * * * *

(e) * * *

(3) * * *

(vii) No corrective distribution of matching contributions other than excess aggregate contributions.

* * * * *

(f) * * *

(16) Section 401(k) plan.

(17) Section 401(m) plan.

* * * * *

**Par. 5.** Section 1.401(m)–1 is amended as follows:

1. Paragraph (a) is revised.

2. Paragraph (b) is amended as follows:

i. Paragraph (b)(1) is revised.

ii. Paragraphs (b)(3)(i) and (b)(3)(ii) are revised.

iii. Paragraph (b)(3)(iii) is removed.

iv. A sentence is added at the end of paragraph (b)(4)(ii)(A).

v. Paragraph (b)(4)(ii)(B) is revised.

vi. Paragraph (b)(5) (i) and (ii) are amended by adding a sentence at the end.

vii. Paragraph (b)(5)(v) is revised.

3. Paragraph (c)(1) is revised.

4. Paragraph (d) is amended as follows:

i. Paragraph (i) of *Example 3* is revised.

ii. Paragraph (i) of *Example 4* is revised.

5. Paragraph (e) is amended as follows:

i. Paragraph (e)(1)(iii) is revised.

ii. A sentence is added at the end of paragraph (e)(3)(ii)(B).

iii. Paragraph (e)(3)(vii) is added.

iv. Paragraph (e)(4) is revised.

v. Paragraph (e)(6) is amended as follows:

a. *Examples 2* through *6* are revised.

b. *Example 8* is added.

6. Paragraph (f) is amended as follows:

i. Paragraphs (f)(1)(ii) (B) and (C)(*1*), and (f)(2) are revised.

ii. A sentence is added at the end of paragraph (f)(4)(ii).

iii. Paragraph (f)(12)(i)(B) is revised.

iv. Paragraphs (f) (16) and (17) are added.

7. Paragraph (g)(4), (g)(5)(ii) (A) and (B)(*2*) are revised.

The added and revised provisions read as follows:

**§ 1.401(m)–1 Employee and matching contributions.**

(a) General Rules—(1) *Nondiscriminatory amount of contributions.* A defined contribution plan does not satisfy section 401(a)(4) for a plan year unless the amount of employee and matching contributions to the plan for the plan year satisfies section 401(a)(4). See § 1.401(a)(4)–1(b)(2)(ii). Except as specifically provided otherwise, for plan years beginning after December 31, 1986 (or such later date provided in paragraph (g) of this section) the amount of employee and matching contributions under a plan satisfies the requirements of section 401(a)(4) only if the employee and matching contributions under the plan satisfy the actual contribution percentage test of section 401(m)(2) and paragraph (b) of this section. See § 1.401(a)(4)–1(b)(2)(ii)(B). Also, except as specifically provided otherwise, for plan years beginning after December 31, 1988 (or such later date provided in

§ 1.401(m)–2(d)), the amount of employee and matching contributions under a plan satisfies the requirements of sections 401(m) and 401(a)(4) only if any multiple use of the alternative methods of compliance with sections 401 (k) and (m) (contained in sections 401(k)(3)(A)(ii)(II) and 401(m)(2)(A)(ii), respectively) is corrected under § 1.401(m)– 2(c). See section 401(m)(9) and § 1.401(m)–2. For these purposes, the employee and matching contributions are combined with the elective and qualified nonelective contributions, if any, that are treated as matching contributions, and the recharacterized elective contributions, if any, that are treated as employee contributions for purposes of section 401(m).

(2) *Other nondiscrimination rules.* Nondiscrimination requirements in addition to those described in paragraph (a)(1) of this section apply to employee and matching contributions under sections 401(a)(4) and 410(b). For example, under section 401(a)(4) a plan may not discriminate with respect to the availability of benefits, rights, and features under the plan. See § 1.401(a)(4)–1(b)(3). The right to make each level of employee contributions, and the right to each level of matching contributions, are benefits, rights, or features subject to this requirement, and each level must therefore generally be available to a group of employees that satisfies section 410(b). See § 1.401(a)(4)–4(e)(3) (i) and (iii) (F) through (G). Thus, for example, a plan does not satisfy section 401(a)(4) if it provides a higher rate of matching contributions for highly compensated employees than for nonhighly compensated employees. See paragraph (e)(4) of this section for rules relating to the application of section 401(a)(4) to the correction of excess aggregate contributions. See § 1.401(a)(4)–11(g)(3)(vii) for special rules relating to correction of violations of the minimum coverage requirements or discriminatory rates of match in a section 401(m) plan. For special rules governing the application of section 410(b) to employee and matching contributions, see §§ 1.410(b)–7(c)(1) and 1.410(b)–8(a)(1).

(3) *Rules applicable to collectively bargained plans.* The requirements of this section are treated as satisfied by employee and matching contributions under a collectively bargained plan (or the portion of a plan) that automatically satisfies section 410(b). See §§ 1.401(a)(4)–1(c)(5) and 1.410(b)–2(b)(7). There are no excess aggregate contributions under a plan (or a portion of a plan) that is treated under this paragraph (a)(3) as satisfying the requirements of this section. Thus, the provisions of section 4979 and § 54.4979–1 of this chapter do not apply to contributions described in the first sentence of this paragraph (a)(3).

(b) *Actual contribution percentage test*—(1) *General rule.* (i) For plan years beginning after December 31, 1986, or such later date provided in paragraph (g) of this section, the actual contribution percentage test is satisfied if—

(A) The actual contribution percentage for the group of eligible highly compensated employees is not more than the actual contribution percentage for the group of all other eligible employees multiplied by 1.25; or

(B) The excess of the actual contribution percentage for the group of eligible highly compensated employees over the actual contribution percentage for the group of all other eligible employees is not more than two percentage points, and the actual contribution percentage for the group of eligible highly compensated employees is not more than the actual contribution percentage for the group of all other eligible employees multiplied by two.

(ii) A plan does not fail to satisfy the requirements of this paragraph (b)(1) merely because all of the eligible employees under the plan for a year are highly compensated employees.

* * * * *

(3) * * * (i) *General rule.* See § 1.401(m)–1(f)(14) for the definition of a plan used for purposes of this section and § 1.401(m)–2. That definition contains the exclusive rules for aggregation and disaggregation of plans for purposes of this section and § 1.401(m)–2.

(ii) *Restructuring and Permissive Disaggregation.* Effective for plan years beginning after December 31, 1991, restructuring under § 1.401(a)(4)–9(c) may not be used to demonstrate compliance with the requirements of section 401(m). See § 1.401(a)(4)–9(c)(3)(ii). For plan years beginning before January 1, 1992, see § 1.401(m)–1(g)(5)(ii). An employer may, however, treat a plan benefiting otherwise excludable employees as two separate plans for purposes of sections 401(m) and 410(b) in accordance with §§ 1.410(b)–6(b)(3) and 1.410(b)–7(c)(3).

(4) * * *

(ii) * * * (A) * * * See §§ 1.401(a)(4)–1(b)(2)(ii)(B); 1.410(b)–7(c)(1).

(B) *Matching contributions and qualified nonelective contributions used to satisfy actual deferral percentage test.* A matching contribution that is treated as an elective contribution is subject to the actual deferral percentage test of section 401(k)(3) and is not taken into account under paragraph (b)(1) of this section. See § 1.401(k)–1(b)(5)(iii) for the rule relating to years before January 1, 1987. A qualified nonelective contribution that is treated as an elective contribution is subject to the actual deferral percentage test of section 401(k)(3) and is not taken into account as a matching contribution under paragraph (b)(1) or (5) of this section.

* * * * *

(5) * * *

(i) * * * See § 1.401(a)(4)–1(b)(2).

(ii) * * * See § 1.401(a)(4)–1(b)(2).

* * * * *

(v) For plan years beginning after December 31, 1988, or such later date provided in paragraph (g) of this section, the plan that takes qualified nonelective contributions and elective contributions into account in determining whether employee and matching contributions satisfy the requirements of section 401(m)(2)(A), and the plans to which the qualified nonelective contributions and elective contributions are made, could be aggregated under § 1.410(b)–7(d) after application of the mandatory disaggregation rules of § 1.410(b)–7(c), as modified in § 1.401(k)–1(g)(11). If the plan year of the section 401(m) plan is changed to satisfy the requirement under § 1.410(b)–7(d)(5) that the aggregated plans have the same plan year, the elective contributions may be taken into account in the resulting short plan year only if these contributions satisfy the requirements of § 1.401(k)–1(b)(4) with respect to the short year, and the qualified nonelective contributions may be taken into account in the resulting short plan year only if these contributions satisfy the requirements of § 1.401(k)–1(b)(4)(i)(A) with respect to the short year as if they were elective contributions.

(c) * * * (1) *Coordination with other plans.* Except as expressly permitted under section 401(k) or 401(m), for plan years beginning after December 31, 1988, or such later date provided in paragraph (g) of this section, employee or matching contributions (or elective contributions treated as matching contributions under paragraph (b)(5) of this section) may not be taken into account for purposes of determining whether any other contributions under any plan (including the plan to which the employee or matching contributions are made) satisfy the requirements of section 401(a). Indeed, the portion of a plan that consists of employee and matching contributions is treated as a

separate plan for purposes of sections 401(a)(4) and 410(b). See § 1.410(b)–7(c)(1). Similarly, although matching contributions and qualified nonelective contributions may be used to enable a plan to satisfy the minimum contribution or benefit requirements under section 416, matching contributions that are used in this way are not treated as matching contributions, and must therefore satisfy the nondiscrimination requirements of section 401(a)(4) without regard to section 401(k) or 401(m). See § 1.416–1, M–18 & M–19 and paragraph (f)(12)(iii) of this section. See also § 1.401(k)–1(b)(5) for circumstances under which matching contributions may be used to determine whether a plan satisfies the requirements of section 401(k). This paragraph does not apply for purposes of determining whether a plan satisfies the average benefit percentage test of section 410(b)(2)(A)(ii).

* * * * *

(d) * * *

*Example 3.* (i) Employer N maintains a plan that contains a cash or deferred arrangement and permits employee contributions. Employer N includes elective contributions in compensation as permitted under § 1.414(s)–1(c)(4)(i). See § 1.401(k)–1(g)(2)(i). For the 1988 plan year, the average percentages of compensation contributed to the plan by the highly compensated and nonhighly compensated employees as elective contributions and employee contributions are shown in the chart below. Elective contributions meet the requirements of paragraph (b)(5) of this section.

| | Elective Contributions (percent) | Employee Contributions (percent) |
|---|---|---|
| Highly compensated ..... | 10 | 10 |
| Nonhighly compensated | 10 | 6 |

* * * * *

*Example 4.* (i) Employer P maintains a plan that includes a cash or deferred arrangement. Elective contributions, qualified nonelective contributions (QNCs), employee contributions, and matching contributions are made to the plan. Employer P includes elective contributions in compensation as permitted under § 1.414(s)–1(c)(4)(i). The elective contributions and QNCs meet the requirements of paragraph (b)(5) of this section. For the 1989 plan year, the QNCs, elective contributions, and employee and matching contributions, expressed as a percentage of compensation, are shown in the following table:

| | QNCs (percent) | Elective Contributions (percent) | Employee/ Matching Contributions (percent) |
|---|---|---|---|
| Highly compensated ..... | 3 | 5 | 6 |
| Nonhighly compensated ..... | 3 | 4 | 2 |

* * * * *

(e) * * *

(1) * * *

(iii) *Impermissible correction methods.* Excess aggregate contributions may not be corrected by forfeiting vested matching contributions, recharacterizing matching contributions, or not making matching contributions required under the terms of the plan. Excess aggregate contributions for a plan year may not remain unallocated or be allocated to a suspense account for allocation to one or more employees in any future year. In addition, excess aggregate contributions may not be corrected using the retroactive correction rules of § 1.401(a)(4)–11(g). See § 1.401(a)(4)–11(g)(3)(vii) and (5). See paragraph (e)(5) of this section for the effects of a failure to correct excess aggregate contributions. See § 1.411(a)–4(b)(7) regarding permissible forfeitures of matching contributions.

* * * * *

(3) * * *

(ii) * * *

(B) * * * See § 1.401(a)(4)–1(c)(8).

* * * * *

(vii) *No corrective distribution of matching contributions other than excess aggregate contributions.* A matching contribution that is an excess aggregate contribution may be distributed as provided in section 401(m)(6) and § 1.401(m)–1(e)(3). A matching contribution may not be distributed merely because the contribution to which it relates is treated as an excess contribution, excess deferral, or excess aggregate contribution. See §§ 1.401(k)–1(f)(5)(iii) and 1.411(a)–4(b)(7) regarding permissible forfeitures of matching contributions that relate to excess contributions, excess deferrals, or excess aggregate contributions.

(4) *Coordination with section 401(a)(4).* A matching contribution is taken into account under section 401(a)(4) even if it is distributed, unless the distributed contribution is an excess aggregate contribution. However, the method of distributing excess aggregate contributions provided in the plan must satisfy the requirements of section 401(a)(4). This requires that after correction each level of matching contributions be currently and effectively available to a group of employees that satisfies section 410(b). See § 1.401(a)(4)–4(e)(3)(iii)(G). Thus, a plan that provides the same rate of matching contributions to all employees will not meet the requirements of section 401(a)(4) if employee contributions are distributed under this paragraph (e) to highly compensated employees to the extent needed to meet the requirements of section 401(m)(2), while matching contributions attributable to employee contributions remain allocated to the highly compensated employees' accounts. See § 1.411(a)–4(b)(7) for a rule that allows forfeiture of these matching contributions to avoid a violation of section 401(a)(4). See also § 1.401(a)(4)–11(g)(3)(vii)(B) regarding the use of additional allocations to the accounts of nonhighly compensated employees for the purpose of correcting a discriminatory rate of matching contributions. A method of distributing excess aggregate contributions will not be considered discriminatory solely because, in accordance with the terms of the plan, unmatched employee contributions that exceed the highest rate at which employee contributions are matched are distributed before matched employee contributions, or matching contributions are distributed (or forfeited) prior to employee contributions. See *Example 6* in paragraph (e)(6) of this section.

* * * * *

(6) * * *

* * * * *

*Example 2.* (i) Employee A is the sole highly compensated participant in a cash or deferred arrangement maintained by

Employer X. The plan that includes the arrangement, Plan X, provides a fully vested matching contribution equal to 50 percent of elective contributions. Plan X is a calendar year plan. Employer X includes elective contributions in compensation as permitted under § 1.414(s)–1(c)(4)(i). See § 1.401(k)–1(g)(2)(i). Plan X corrects excess contributions by recharacterization. For the 1988 plan year, A's compensation is $58,333, and A's elective contributions are $7,000. The actual deferral percentages and actual contribution percentages of A and other employees under Plan X are shown below:

| | Actual deferral percentage | Actual contribution percentage |
|---|---|---|
| Employee A | 12 | 6 |
| Nonhighly compensated | 8 | 4 |

(ii) In February 1989, Employer X determines that A's actual deferral ratio must be reduced to 10 percent, or $5,833, which requires a recharacterization of $1,167 as an employee contribution. This increases A's actual contribution ratio to eight percent ($3,500 in matching contributions plus $1,167 recharacterized as employee contributions, divided by $58,333 in compensation). Since A's actual contribution ratio must be limited to six percent for Plan X to satisfy the actual contribution percentage test, Plan X must distribute $1,167 of A's employee and matching contributions. If $1,167 in matching contributions is distributed, this will correct the excess aggregate contributions and will not result in a discriminatory rate of matching contributions. See *Example 8.*

*Example 3.* Same as *Example 2,* except that in 1988 A also had elective contributions of $1,313 under Plan Y, maintained by an employer unrelated to X. In January 1989, A requests and receives a distribution of $1,000 in excess deferrals from Plan X. Pursuant to the terms of Plan X, A forfeits the $500 match on the excess deferrals to correct a discriminatory rate of match (see *Example 8*). The $1,167 that would otherwise have been recharacterized for Plan X to satisfy the actual deferral percentage test is reduced by the $1,000 already distributed as an excess deferral, leaving $167 to be recharacterized. See § 1.401(k)–1(f)(5)(i). Pursuant to the terms of Plan X, A forfeits the $83.50 match on the recharacterized $167 to correct a discriminatory rate of match. A's actual contribution ratio is now 5.29 percent ($2,916.50 ($3,500–$500–$83.50)) in matching contributions plus $167 in employee contributions, divided by $58,333 in compensation). Since Plan X satisfies the actual contribution percentage test, no further distribution is required or permitted.

*Example 4.* Same as *Example 3,* except that A does not request a distribution of excess deferrals until March 1989. Employer X has already recharacterized $1,167 as employee contributions. Under § 1.402(g)–1(e)(6), the amount of excess deferrals is reduced by the amount of excess contributions that are recharacterized. Because the amount recharacterized is greater than the excess deferrals, Plan X is neither required nor permitted to make a distribution of excess deferrals, and the recharacterization has corrected the excess deferrals.

*Example 5.* For the 1987 plan year, Employee B defers $7,000 under Plan C and $1,000 under plan D. Plans C and D are maintained by unrelated Employers C and D; both Plans C and D have calendar plan years. Plan C provides a fully vested, 100 percent matching contribution and does not take elective contributions into account under section 401(m) or take matching contributions into account under section 401(k). Employer C determines that B has excess contributions of $600 and excess aggregate contributions of $1,600. B timely requests and receives a distribution of the $1,000 excess deferral from Plan C, and pursuant to the terms of Plan C, forfeits the corresponding $1,000 matching contribution to correct a discriminatory rate of match (see *Example 8*). Plan C provides that excess contributions and excess aggregate contributions are corrected by distribution. No distribution is required or permitted to correct the excess contributions because $1,000 has been distributed from this plan as excess deferrals. The distribution required to correct the excess aggregate contributions (after forfeiting the matching contribution) is $600 ($1,600 in excess aggregate contributions minus $1,000 in forfeited matching contributions). If B had corrected the excess deferrals of $1,000 by withdrawing $1,000 from Plan D, Plan C would have had to correct the $600 excess contributions in Plan C by distributing $600. Since B then would have forfeited $600 (instead of $1,000) in matching contributions, B would have had $1,000 ($1,600 in excess aggregate contributions minus $600 in forfeited matching contributions) remaining of excess aggregate contributions in Plan C. These would have been corrected by distributing an additional $1,000 from Plan C.

*Example 6.* Employee B is the sole highly compensated employee in a thrift plan under which the employer matches 100 percent of employee contributions up to two percent of compensation, and 50 percent of employee contributions up to the next four percent of compensation. For the 1988 plan year, B has compensation of $100,000. B makes an employee contribution of $7,000, or seven percent, and receives a four percent matching contribution of $4,000. Thus, B's actual contribution ratio (ACR) is 11 percent. The actual contribution percentage for the nonhighly compensated employees is five percent, and the employer determines that B's ACR must be reduced to seven percent to comply with the rules of section 401(m). In this case, the plan satisfies the requirements of this paragraph if it distributes the unmatched employee contributions of $1,000, and $2,000 of matched employee contributions with their related matches of $1,000. This would leave B with four percent employee contributions, and three percent matching contributions, for an ACR of seven percent. The plan could instead distribute all matching contributions. The plan would fail to meet the requirements of this paragraph if it distributed $4,000 (four percent) of B's employee contributions and none of B's matching contributions because this would result in a discriminatory rate of matching contributions. See § 1.401(m)–1(e)(2) and (4). See also *Example 8.*

* * * * *

*Example 8.* (i) Employer B maintains a calendar year profit sharing plan that includes a cash or deferred arrangement. Elective contributions are matched at the rate of 100 percent. After-tax employee contributions are permitted under the plan only for nonhighly compensated employees and are matched at the same rate. No employees make excess deferrals. Employee A, a highly compensated employee, makes an $8,000 elective contribution and receives an $8,000 matching contribution.

(ii) Employer B performs the actual deferral percentage (ADP), the actual contribution percentage (ACP), and the multiple use tests. To correct failures of the ADP and ACP tests, the plan distributes to A $1,000 of excess contributions and $500 of excess aggregate contributions. After the distributions, A's contributions for the year are $7,000 of elective contributions and $7,500 of matching contributions. As a result, A has received a higher effective rate of matching contributions than nonhighly compensated employees ($7,000 of elective contributions matched by $7,500 is an effective matching rate of 107 percent). If this amount remains in A's account without correction, it will cause the plan to fail to satisfy section 401(a)(4), because only a highly compensated employee receives the higher matching contribution rate. The remaining $500 matching contribution may be forfeited (but not distributed) under section 411(a)(3)(G), if the plan so provides. The plan could instead correct the discriminatory rate of matching contributions by making additional allocations to the accounts of nonhighly compensated employees. See § 1.401(a)(4)–11(g)(3)(vii)(B) and (6), *Example 7.*

(f) * * *

(1) * * *

(ii) * * *

(B) *Highly compensated employee eligible under more than one plan.* The actual contribution ratio of a highly compensated employee who is eligible to participate in more than one plan of an employer to which employee or matching contributions are made is calculated by treating all the plans in which the employee is eligible to participate as one plan. However, plans that are not permitted to be aggregated under § 1.410(b)–7(c), as modified in § 1.401(k)–1(g)(11), are not aggregated for this purpose. For example, if a highly compensated employee with compensation of $80,000 may receive matching contributions under two plans of an employer, the employee's actual contribution ratio under each plan is calculated by dividing the employee's total matching contributions under both plans by $80,000, unless the plans are required to be disaggregated. In that case, the actual contribution ratio of the employee under each plan is to be

calculated by dividing the employee's matching contributions under that plan by $80,000. See paragraph (b)(3) of this section for the treatment of certain multiple plans. For plan years beginning after December 31, 1988, or such later date provided in paragraph (g) of this section, if a highly compensated employee participates in two or more plans that have different plan years, this paragraph (f)(1)(ii) is applied by treating all plans whose plan years end with or within the same calendar year as a single plan.

(C) *Employees subject to family aggregation rules—(1)* Aggregation of employee contributions and other amounts. For plan years beginning after December 31, 1986, or such later date provided in paragraph (g) of this section, if a highly compensated employee is subject to the family aggregation rules of section 414(q)(6) because that employee is either a five-percent owner or one of the 10 most highly compensated employees, the combined actual contribution ratio for the family group (treated as one highly compensated employee) must be determined by combining the employee contributions, matching contributions, amounts treated as matching contributions, and compensation of all family members.

* * * * *

(2) *Compensation.* The term *compensation* means compensation as defined in § 1.401(k)–1(g)(2)(i).

* * * * *

(4) * * *

(ii) * * * In no event is an election made after December 23, 1994 treated as a one-time irrevocable election under this paragraph if the election is made by an employee who previously became eligible under another plan (whether or not terminated) of the employer.

* * * * *

(12) * * *

(i) * * *

(B) Any employer contribution (including a contribution made at the employer's discretion) to a defined contribution plan on account of an elective deferral (as defined in § 1.402(g)–1(b)); and

* * * * *

(16) *Section 401(k) plan.* The term *section 401(k) plan* means a section 401(k) plan within the meaning of § 1.410(b)–9.

(17) *Section 401(m) plan.* The term *section 401(m) plan* means a section 401(m) plan within the meaning of § 1.410(b)–9.

(g) * * *

(4) *State and local government plans.* A governmental plan described in section 414(d), including a plan subject to section 403(b)(12)(A)(i) (nonelective plan) is treated as satisfying section 401(m) for plan years beginning before the later of January 1, 1996, or 90 days after the opening of the first legislative session beginning on or after January 1, 1996, of the governing body with authority to amend the plan, if that body does not meet continuously. For purposes of this paragraph (g)(4), the term *governing body with authority to amend the plan* means the legislature, board, commission, council, or other governing body with authority to amend the plan.

(5) * * *

(ii) * * * (A) *General rule.* In determining whether the requirements of section 401(m) are satisfied for plan years beginning before January 1, 1992, a plan may be treated as consisting of two or more component plans, each consisting of all of the allocations and other benefits, rights, and features provided to a group of employees under the plan. See § 1.401(a)(4)–9(c). An employee may not be included in more than one component plan of the same plan for a plan year under this method. If this method is used for a plan year, the requirements of section 401(m) are applied separately with respect to each component plan for the plan year. Thus, for example, the actual contribution ratio and the amount of excess aggregate contributions, if any, of each eligible employee under each component plan must be determined as if the component plan were a separate plan. This method applies solely for purposes of section 401(m). Thus, for example, the requirements of section 410(b) must still be satisfied by the entire plan.

(B) * * *

(2) *Commonality requirement.* The group of employees used to identify a component plan must share some common attribute or attributes, other than similar actual contribution ratios. Permissible common attributes include, for example, employment at the same work site, in the same job category, for the same division or subsidiary, or for a unit acquired in a specific merger or acquisition, employment for the same number of years, compensation under the same method (e.g., salaried or hourly), coverage under the same contribution formula, and attributes that could be used as the basis of a classification that would be treated as reasonable under § 1.410(b)–4(b). Employees whose only common attribute is the same or similar actual contribution ratios, or another attribute having substantially the same effect as the same or similar actual contribution ratios, are not considered as sharing a common attribute for this purpose. This rule applies regardless of whether the component plan or the plan of which it is a part satisfies the ratio or percentage test of section 410(b).

**Par. 6.** Section 1.401(m)–2 is amended as follows:

1. A sentence is added at the end of paragraph (a).

2. Paragraph (b)(1) is revised.

3. Paragraph (c)(1) and (c)(4), *Example 1* (i), is revised.

4. The added and revised provisions read as follows:

**§ 1.401(m)–2 Multiple use of alternative limitation.**

(a) * * * The consequences of multiple use of the alternative methods of compliance are described in § 1.401(m)–1(a)(1).

(b) *General rule for determination of multiple use—(1) In general.* (i) Multiple use of the alternative limitation occurs if all of the conditions of this paragraph (b)(1) are satisfied:

(A) One or more highly compensated employees of the employer are eligible employees in both a cash or deferred arrangement subject to section 401(k) and a plan maintained by the employer subject to section 401(m).

(B) The sum of the actual deferral percentage of the entire group of eligible highly compensated employees under the arrangement subject to section 401(k) and the actual contribution percentage of the entire group of eligible highly compensated employees under the plan subject to section 401(m) exceeds the aggregate limit of paragraph (b)(3) of this section.

(C) The actual deferral percentage of the entire group of eligible highly compensated employees under the arrangement subject to section 401(k) exceeds the amount described in section 401(k)(3)(A)(ii)(I).

(D) The actual contribution percentage of the entire group of eligible highly compensated employees under the arrangement subject to section 401(m) exceeds the amount described in section 401(m)(2)(A)(i).

(ii) The actual deferral percentage and actual contribution percentage of the group of eligible highly compensated employees are determined after use of qualified nonelective contributions and qualified matching contributions to meet the requirements of section 401(k)(3)(A)(ii) and after use of qualified nonelective contributions and elective contributions to meet the requirements of section 401(m)(2)(A). The actual deferral percentage and actual contribution percentage of the group of eligible highly compensated employees are determined after any corrective

distribution or forfeiture of excess deferrals, excess contributions, or excess aggregate contributions and after any recharacterization of excess contributions required without regard to this section. Only plans and arrangements maintained by the same employer are taken into account under this paragraph (b)(1). If the employer maintains two or more plans after application of the rules under § 1.401(k)– 1(g)(11), multiple use is tested separately with respect to each plan. Thus, for example, if an employer maintains a cash or deferred arrangement with matching contributions, under which elective contributions may be made under either an ESOP or a non-ESOP, multiple use is tested separately with respect to elective contributions and matching contributions under the ESOP, and with respect to elective contributions and matching contributions under the non-ESOP.

* * * * *

(c) * * * (1) *In general.* If multiple use of the alternative limitation occurs with respect to two or more plans or arrangements maintained by an employer, it must be corrected by reducing the actual deferral percentage, the actual contribution percentage of highly compensated employees, or a combination of the two, in the manner described in paragraph (c)(3) of this section. Instead of making this reduction, the employer may eliminate the multiple use of the alternative limitation by making qualified nonelective contributions in accordance with § 1.401(k)–1(b)(5) and (f)(1) or § 1.401(m)–1(b)(5) and (e)(1).

* * * * *

(4) * * *

*Example 1.* (i) All employees of Employer Q are eligible in both an arrangement subject to section 401(k) and a plan subject to section 401(m). Both plans have a calendar plan year. The plans provide that multiple use of the alternative limitation will be corrected in the plan subject to section 401(m) and that any required reduction in actual contribution ratios will apply only to employees eligible to participate in both arrangements. Employer Q includes elective contributions in compensation as permitted under § 1.414(s)–1(c)(4)(i). See § 1.401(k)–1(g)(2)(i). Employees X and Y are highly compensated. Each received compensation of $100,000, deferred $6,000, received a $3,000 matching contribution, and made employee contributions of $3,000. Actual deferral and contribution percentages under the arrangement and plan for the 1989 plan year are shown below. No excess deferrals, excess contributions, or excess aggregate contributions have yet been required to be distributed, forfeited, or recharacterized under the plan.

| | Actual deferral percentage | Actual contribution percentage |
|---|---|---|
| Highly compensated ..... | 6 | 6 |
| Nonhighly compensated | 4 | 4 |

* * * * *

**Par. 7.** Section 1.402(a)–1 is amended as follows:

1. Paragraph (d)(3)(iv) is revised.

2. Paragraph (d)(3)(v) is added.

3. The added and revised provisions read as follows:

**§ 1.402(a)–1 Taxability of beneficiary under a trust which meets the requirements of section 401(a).**

* * * * *

(d) * * *

(3) * * *

(iv) *Special rule for collectively bargained plans.* For plan years beginning before January 1, 1993, a nonqualified cash or deferred arrangement will be treated as satisfying section 401(k)(3) solely for purposes of paragraph (d)(2)(i) of this section if it is part of a plan (or portion of a plan) that automatically satisfies section 401(a)(4) under § 1.401(k)–1(a)(7), relating to certain collectively bargained plans.

(v) *Special rule for governmental plans.* For plan years beginning before the later of January 1, 1996, or 90 days after the opening of the first legislative session beginning on or after January 1, 1996, of the governing body with authority to amend the plan, if that body does not meet continuously, in the case of governmental plans described in section 414(d), a nonqualified cash or deferred arrangement will be treated as satisfying section 401(k)(3) solely for purposes of paragraph (d)(2)(i) of this section if it is part of a plan adopted by a state or local government before May 6, 1986. For purposes of this paragraph (d)(3)(v), the term *governing body with authority to amend the plan* means the legislature, board, commission, council, or other governing body with authority to amend the plan.

**Par. 8.** Section 1.402(g)–1 is amended as follows:

1. Paragraph (e)(5)(ii) is revised.

2. In paragraph (e)(11), paragraph (iv) of *Example 2,* is revised and paragraph (v) is removed.

3. The added and revised provisions read as follows:

**§ 1.402(g)–1 Limitation on exclusion for elective deferrals.**

(e) * * *

(5) * * *

(ii) *Method of allocating income.* A plan may use any reasonable method for computing the income allocable to excess deferrals, provided that the method does not violate section 401(a)(4), is used consistently for all participants and for all corrective distributions under a plan for the plan year, and is used by the plan for allocating income to participants' accounts. See § 1.401(a)(4)–1(c)(8).

* * * * *

(11) * * *

*Example 2.* * * *

(iv) In February 1990, B notifies X that B made elective deferrals of $2,000 under a qualified cash or deferred arrangement maintained by an unrelated employer in 1989, and requests distribution of $2,000 from X's plan. However, since B has already received a distribution of $2,002 to meet the ADP test, no additional amounts are required or are permitted to be distributed as excess deferrals by this plan, and the prior distribution of excess contributions has corrected the excess deferrals. But X must report $2,000 as a distribution of an excess deferral and $2 as a distribution of an excess contribution.

* * * * *

**Par. 9.** In § 1.411(d)–4, A–2 is amended by revising paragraph (b)(2) (x) and (xi) to read as follows:

**1.411(d)–4 Section 411(d)(6) protected benefits.**

* * * * *

A–2: * * *

(b) * * *

(2) * * *

(x) *Amendment of hardship distribution standards.* A qualified cash or deferred arrangement that permits hardship distributions under § 1.401(k)–1(d)(2) may be amended to specify or modify nondiscriminatory and objective standards for determining the existence of an immediate and heavy financial need, the amount necessary to meet the need, or other conditions relating to eligibility to receive a hardship distribution. For example, a plan will not be treated as violating section 411(d)(6) merely because it is amended to specify or modify the resources an employee must exhaust to qualify for a hardship distribution or to require employees to provide additional statements or representations to establish the existence of a hardship. A qualified cash or deferred arrangement may also be amended to eliminate hardship distributions. The provisions of this paragraph also apply to profit-sharing or stock bonus plans that permit hardship distributions, whether or not the hardship distributions are limited to those described in § 1.401(k)–1(d)(2).

(xi) *Section 415 benefit limitations.* Accrued benefits under a plan as of the first day of the first limitation year beginning after December 31, 1986, that exceed the benefit limitations under

section 415 (b) or (e), effective on the first day of the plan's first limitation year beginning after December 31, 1986, because of a change in the terms and conditions of the plan made after May 5, 1986, or the establishment of a plan after that date, may be reduced to the level permitted under section 415 (b) or (e).

* * * * *

**Par. 10.** Section 1.415–6 is amended by revising paragraph (b)(6)(iv) to read as follows:

**§ 1.415–6 Limitation for defined contribution plans.**

* * * * *

(b) * * *

(6) * * *

(iv) Notwithstanding paragraph (b)(6)(i), (ii), or (iii) of this section, the plan may provide for the distribution of elective deferrals (within the meaning of section 402(g)(3)) or the return of employee contributions (whether voluntary or mandatory), and for the distribution of gains attributable to those elective deferrals and employee contributions, to the extent that the distribution or return would reduce the excess amounts in the participant's account. These distributed or returned amounts are disregarded for purposes of section 402(g), the actual deferral percentage test of section 401(k)(3), and the actual contribution percentage test of section 401(m)(2). However, the return of mandatory employee contributions may result in discrimination in favor of highly compensated employees. If the plan does not provide for the return of gains attributable to the returned employee contributions, such earnings will be considered as an employee contribution for the limitation year in which the returned contribution was made. For limitation years beginning after December 31, 1995, if a plan does not provide for the distribution of gains attributable to the distributed elective deferrals, such earnings will be considered as an employer contribution for the limitation year in which the distributed elective deferral was made. If a suspense account is in existence at any time during the limitation year in accordance with this subparagraph, investment gains and losses and other income may, but need not, be allocated to the suspense account. To the extent that investment gains or other income or investment losses are allocated to the suspense account, the entire amount allocated to participants from the suspense account, including any such gains or other income or less any such losses, is considered as the annual addition. See § 1.401(a)–2(b) for provisions relating to the disposition of a suspense account in existence upon termination of a plan.

* * * * *

## PART 54—PENSION EXCISE TAXES

**Par. 11.** The authority citation for part 54 continues to read in part as follows:

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

**Par. 12.** Section 54.4979–0 is amended as follows:

1. The entry for § 54.4979–1, paragraph (d)(4) is revised.
2. The entry for § 54.4979–1, paragraph (d)(5) is removed.

The revised entry reads as follows:

**§ 54.4979–0. Excise tax on certain excess contributions and excess aggregate contributions, table of contents.**

* * * * *

*§ 54.4979–1* * **

(d) * * *

(4) Plan years beginning before January 1, 1992.

**Par. 13.** Section 54.4979–1 is amended as follows:

1. Paragraph (d)(1) is revised.
2. Paragraph (d)(3) is revised.
3. Paragraph (d)(4) is removed.
4. Paragraph (d)(5) is redesignated as paragraph (d)(4).

The revised provisions read as follows:

**§ 54.4979–1 Excise tax on certain excess contributions and excess aggregate contributions.**

(d) *Effective date*—(1) *General rule.* Except as provided in paragraphs (d)(2) through (4), this section is effective for plan years beginning after December 31, 1986.

* * * * *

(3) *Collectively bargained plans and plans of state or local governments.* For plan years beginning before January 1, 1993, the provisions of this section do not apply to a collectively bargained plan that automatically satisfies the requirements of section 410(b). See §§ 1.401(a)(4)–1(c)(5) and 1.410(b)–2(b)(7) of this chapter. In the case of a plan (including a collectively bargained plan) maintained by a state or local government, the provisions of this section do not apply for plan years beginning before the later of January 1, 1996, or 90 days after the opening of the first legislative session beginning on or after January 1, 1996, of the governing body with authority to amend the plan, if that body does not meet continuously. For purposes of this paragraph (d)(3), the term *governing body with authority to amend the plan* means the legislature, board, commission, council, or other governing body with authority to amend the plan.

(4) *Plan years beginning before January 1, 1992.* * * *

**Margaret Milner Richardson,**

*Commissioner of Internal Revenue.*

Approved: December 13, 1994.

**Leslie Samuels,**

*Assistant Secretary of the Treasury.*

[FR Doc. 94–31427 Filed 12–22–94; 8:45 am]

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## 26 CFR Parts 1 and 602

**[T.D. 8578]**

**RIN 1545–AP23**

## Election Out of Subchapter K for Producers of Natural Gas

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations.

**SUMMARY:** This document contains final regulations that amend the regulations under section 761 of the Internal Revenue Code relating to the election out of subchapter K of chapter 1 of the Code. The final regulations contain certain requirements that must be met by co-producers of natural gas subject to a joint operating agreement in order to make or maintain an election under section 761. The final regulations provide that the co-producers under a joint operating agreement must use one of two permissible methods described in the regulations in reporting income from gas sales and certain related deductions and credits.

**EFFECTIVE DATE:** January 1, 1995.

**FOR FURTHER INFORMATION CONTACT:** Grace Kim, 202–622–3060 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

### Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act (44 U.S.C. 3504(h)) under control number 1545–1338. The estimated annual burden per respondent/recordkeeper varies from 15 minutes to 45 minutes depending on individual circumstances, with an estimated average of 30 minutes.

These estimates are approximations. They are based on such information as is available to the Internal Revenue Service. Individual respondents/recordkeepers may require more or less time, depending on their particular circumstances.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, T:FP, Washington, D.C. 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, D.C. 20503.

**Background**

On September 16, 1992, a notice of proposed rulemaking (PS–103–90) was published in the **Federal Register** (57 FR 42712) proposing amendments to the Income Tax Regulations (26 CFR part 1, 602) under section 761 of the Internal Revenue Code (Code). A notice of hearing relating to the proposed regulations was published in that same issue (57 FR 42720), and a public hearing was held on November 17, 1992. After consideration of all written and oral comments regarding the proposed amendments, the proposed regulations are adopted as revised by this Treasury decision. These regulations are issued under the authority contained in sections 446(b), 761(a), and 7805.

**Explanation of Provisions**

*In General*

Except for modifications in response to comments, these final regulations generally provide the same rules as the proposed regulations. Thus, the final regulations prescribe the methods of accounting for gas sales that may be used by co-producers of a gas producing property that seek to make or maintain an election under section 761(a) of the Code. Co-producers must use either the cumulative gas balancing method (cumulative method) or the annual gas balancing method (annual method). The final regulations require permission of the Commissioner to use the annual method. This is to ensure that the co-producers (particularly those with different taxable year-ends) properly take income and deductions into account.

**Changes to the Proposed Regulations in Response to Comments**

*I. Effective Date and Transitional Rules*

The proposed regulations apply to co-producers under an existing gas balancing agreement (GBA) or "any agreement similar to a gas balancing agreement" in effect on or after September 16, 1992, for taxable years beginning on or after that date. They also provide an automatic consent procedure for gas co-producers under existing GBAs to change their method of accounting and the rules for taking the related section 481(a) adjustments into account.

Commentators have expressed uncertainty as to the meaning of "an agreement similar to a gas balancing agreement," *e.g.*, whether a joint operating agreement (JOA), without a formal GBA, is a similar agreement. Additionally, commentators asserted that the automatic consent procedure was overly burdensome and the section 481(a) adjustment rules were in some cases impractical. Some recommended that the regulations be entirely prospective and that the effective date be delayed.

The final regulations are revised to remove the uncertainty concerning the meaning of "an agreement similar to a gas balancing agreement," and are to apply to all gas co-producers operating under a JOA, without regard to whether a GBA exists. Additionally, the final regulations are revised to simplify the automatic consent procedure and to delay the effective date so as to apply to gas co-producers under JOAs in effect on or after the start of their first taxable year beginning after December 31, 1994. If, however, the co-producers under a JOA do not all have the same taxable year and they are changing to the annual method, the regulations apply on and after January 1, 1996, with respect to that JOA. Finally, although the final regulations maintain the six-year section 481(a) adjustment period, they are revised to add an election to take an aggregate section 481(a) adjustment for all JOAs, whether negative or positive, into account in the year of the change in method of accounting.

*II. Entitlements Method as Elective Method*

A commentator suggested that the entitlements method be adopted as an elective method or as a replacement for the annual method. Under the entitlements method, a co-producer reports income currently only for its proportionate share of current production under the JOA.

The final regulations do not adopt this suggestion because total income for tax purposes should be reported on the basis of the relative economics of current production, rather than entitlement under the JOA.

*III. Consequences of Noncompliance*

Commentators indicated that the requirement of the proposed regulations that all co-producers under the same GBA use the same permissible gas balancing method might be construed as meaning that one co-producer's noncompliance would cause the section 761 election of all of the co-producers to be revoked.

Accordingly, the final regulations are revised to require that all co-producers under a JOA use the cumulative method, unless the co-producers are eligible to, and agree in writing, to use the annual method. The final regulations also clarify that the failure of a co-producer to follow this rule will be treated as the use of an impermissible method of accounting, but will not cause the co-producers' section 761 election to be revoked, unless the Commissioner determines that there was willful failure to comply.

*IV. The Standard for Revoking a Section 761 Election Under the Cumulative Method*

The proposed regulations contain an anti-abuse rule under which the section 761 election of certain co-producers using the cumulative method could be revoked. The standard for applying the anti-abuse rule is a determination that "a principal purpose" of shifting income, deductions, or credits is to avoid tax. Commentators suggested replacing "a principal purpose" with "the principal purpose." After careful consideration of the comments, the Service and Treasury have concluded that the standard contained in the proposed regulations is appropriate. Thus, the anti-abuse rule in the proposed regulations is finalized.

*V. Requests for Clarification Under the Cumulative Method*

Commentators requested certain clarifying changes under the cumulative method relating to depletion deductions and the section 29 credit for producing fuel from a nonconventional source. First, the rule that a taking co-producer's deduction for making a payment to a co-producer is reduced by the amount of any depletion deduction allowed on the related gas sales is revised to make it clear that the payment deduction is reduced only by the taking co-producer's percentage depletion deduction allowed on the related sales. The final regulations are not modified to clarify the section 29 credit issues because this project is not the appropriate one for addressing these issues.

**Special Analyses**

It has been determined that these regulations are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C.

chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking for the regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

**Drafting Information**

The principal author of these regulations is H. Grace Kim of the Office of Assistant Chief Counsel (Passthroughs and Special Industries), Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

**List of Subjects**

*26 CFR Part 1*

Income taxes, Reporting and recordkeeping requirements.

*26 CFR Part 602*

Reporting and recordkeeping requirements.

**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

## PART 1—INCOME TAXES

**Paragraph 1.** The authority citation for part 1 is amended by adding the following citation:

**Authority:** 26 U.S.C. 7805 * * *. Section 1.761–2 also issued under 26 U.S.C. 446(b) and 26 U.S.C. 761(a). * * *

**Par. 2.** Section 1.761–2 is amended as follows:

1. The section heading for § 1.761–2 is revised.
2. A sentence is added to the end of paragraph (a)(3) concluding text.
3. Paragraph (d) is redesignated as paragraph (e).
4. New paragraph (d) is added.
5. The revised and added provisions read as follows:

**§ 1.761–2 Exclusion of certain unincorporated organizations from the application of all or part of subchapter K of chapter 1 of the Internal Revenue Code.**

(a) * * *

(3) * * *

* * * In addition, except as provided in paragraph (d)(2)(i) of this section, this paragraph (a)(3) does not apply to any unincorporated organization that produces natural gas under a joint operating agreement, unless all members of the unincorporated organization comply with paragraph (d) of this section.

* * * * *

(d) *Rules for gas producers that produce natural gas under joint operating agreements*—(1) *Joint operating agreements and gas balancing.* Co-owners of a property producing natural gas enter into a joint operating agreement (JOA) to define the rights and obligations of each co-producer of the gas in place. The JOA determines, among other things, each co-producer's proportionate share of the natural gas as it is produced from the reservoir, together with the associated production expenses. A gas imbalance arises when a co-producer does not take its proportionate share of current gas production under the JOA (underproducer) and another co-producer takes more than its proportionate share of current production (overproducer). The co-producers often enter into a gas balancing agreement (GBA) as an addendum to their JOA to establish their rights and obligations when a gas imbalance arises. A GBA typically allows the overproducer to take the amount of the gas imbalance (overproduced gas) and entitles the underproducer to recoup the overproduced gas either from the volume of the gas remaining in the reservoir or by a cash balancing payment.

(2) *Permissible gas balancing methods*—(i) *General requirement.* All co-producers of natural gas operating under the same JOA must use the cumulative gas balancing method, as described in paragraph (d)(3) of this section, unless they use the annual gas balancing method described in paragraph (d)(4) of this section. A co-producer's failure to comply with the provisions of this paragraph (d)(2)(i) generally constitutes the use of an impermissible method of accounting, requiring a change to a permissible method under § 1.4461(e)(3) with any terms and conditions as may be imposed by the Commissioner. The co-producers' election to be excluded from all or part of subchapter K will not be revoked, unless the Commissioner determines that there was willful failure to comply with the requirements of this paragraph (d)(2)(i).

(ii) *Change in method of accounting; adoption of method of accounting*—(A) *In general.* The annual gas balancing method and the cumulative gas balancing method are methods of accounting. Accordingly, a change to or from either of these methods is a change in method of accounting that requires the consent of the Commissioner. See section 446(e) and § 1.446–1(e). For purposes of this section, each JOA is treated as a separate trade or business. Paragraph (d)(2)(ii)(B) of this section provides rules for adopting either permissible method of accounting. Paragraph (d)(2)(ii)(C) of this section provides rules on the timing of required changes to either permissible method during the transitional period, and paragraph (d)(5) of this section contains the procedural provisions for making a change in method of accounting required in paragraph (d)(2)(ii)(C) of this section.

(B) *Adoption of method of accounting.* A co-producer must adopt a permissible method for each JOA entered into on or after the start of the co-producer's first taxable year beginning after December 31, 1994 (or, in the case of the use of the annual gas balancing method by co-producers not having the same taxable year, the start of the first taxable year beginning after December 31, 1994, of the co-producer whose taxable year begins latest in the calendar year). If a co-producer is adopting the cumulative method, the co-producer may adopt the method by using the method on its timely filed return for the taxable year of adoption. A co-producer may adopt the annual gas balancing method with the permission of the Commissioner under guidelines set forth in paragraph (d)(4)(ii) of this section.

(C) *Required change in method of accounting for certain joint operating agreements.* This paragraph (d)(2)(ii)(C) applies to certain JOAs entered into prior to 1996. Except in the case of a part-year change in method of accounting or in the case of the cessation of a JOA (both of which are described in this paragraph (d)(2)(ii)(C)), for each JOA entered into prior to a co-producer's first taxable year beginning after December 31, 1994, and in effect as of the beginning of that year, the co-producer must change its method of accounting for sales of gas and its treatment of certain related deductions and credits to a permissible method as of the start of its first taxable year beginning after December 31, 1994. In the case of a JOA of co-producers that do not all have the same taxable year and that choose the annual gas balancing method, if the JOA is entered into prior to the first taxable year beginning after December 31, 1994 of the co-producer whose taxable year begins latest in the calendar year and the JOA is in effect as of January 1, 1996, a change to the annual gas

balancing method by each co-producer under that JOA is made as of January 1, 1996 (part-year change in method of accounting). If the co-producers would have made a part-year change to the annual gas balancing method but for the fact that their JOA ceased to be in effect before January 1, 1996 (cessation of a JOA), the co-producers do not change their method of accounting with respect to the JOA. Rather, for their taxable years in which the JOA ceases to be in effect, the co-producers use their current method of accounting with respect to that JOA.

(3) *Cumulative gas balancing method*—(i) *In general.* The cumulative gas balancing method (cumulative method), solely for purposes of reporting income from gas sales and certain related deductions and credits, treats each co-producer under the same JOA as the sole owner of its percentage share of the total gas in the reservoir and disregards the ownership arrangement described in the JOA for gas as it is produced from the reservoir. Each co-producer is considered to be taking only its share of the total gas in the reservoir as long as the gas remaining in the reservoir is sufficient to satisfy the ownership rights of the co-producers in their percentage shares of the total gas in the reservoir. After a co-producer has taken its entire share of the total gas in the reservoir, any additional gas taken by that co-producer (taking co-producer) is treated as having been taken from its other co-producers' shares of the total gas in the reservoir. The effect of being treated as a taking co-producer under the cumulative method is that the taking co-producer generally may not claim an allowance for depletion and a production credit on its sales of its other co-producers' percentage shares of the total gas in the reservoir.

(ii) *Requirements*—(A) *Reporting of income from sales of gas.* Under the cumulative method, each co-producer must include in gross income under its overall method of accounting the amount of its sales from all gas produced from the reservoir, including sales of gas taken from another co-producer's share of the gas in the reservoir.

(B) *Reporting of deduction of taking co-producer.* A taking co-producer deducts the amount of a payment (in cash or property, other than gas produced under the JOA) made to another co-producer for sales of that co-producer's gas, but only for the taxable year in which the payment is made. Thus, an accrual method taking co-producer is not permitted a deduction for any obligation it has to pay another co-producer for sales of that co-producer's gas until a payment is made. See paragraph (d)(3)(iii)(B) of this section for a rule requiring a reduction of the amount of the deduction described in this paragraph (d)(3)(ii)(B) if the taking co-producer had mistakenly claimed a depletion deduction relating to those sales.

(C) *Reporting of income by other co-producers.* Any co-producer that is entitled to receive a payment from a taking co-producer must include the amount of the payment in gross income as proceeds from the sale of its gas only for the taxable year that the payment is actually received, regardless of its overall method of accounting.

(D) *Reporting of production expenses.* Each co-producer deducts its proportionate share of production expenses, as provided in the JOA, under its regular method of accounting for the expenses.

(iii) *Special rules for production credits and depletion deductions under the cumulative method*—(A) *In general.* Under the cumulative method, a co-producer's depletion allowance and production credit for a taxable year are based on its income from gas sales and production of gas from its percentage share of the total gas in the reservoir, and are not based on its current proportionate share of income and production as determined under the JOA. Thus, in general, a taking co-producer is not allowed a production credit or an allowance for depletion on its sales of gas in excess of its percentage share of the total gas in the reservoir. However, the Service will not disallow depletion deductions or production credits claimed by a taking co-producer on the gas of other co-producers if the taking co-producer had a reasonable but mistaken belief that the deductions or credits were claimed with respect to the taking co-producer's percentage share of total gas in the reservoir and the taking co-producer makes the appropriate reductions and additions to tax required in paragraphs (d)(3)(iii)(B) and (d)(3)(iii)(C) of this section. The reasonableness of the mistaken belief is determined at the time of filing the return claiming the deductions or credits. A co-producer receiving a payment for sales of its gas from a taking co-producer claims a production credit and an allowance for depletion relating to those sales only for the taxable year in which the amount of the payment is included in its gross income.

(B) *Reduction of taking co-producer's payment deduction for depletion claimed on another co-producer's gas.* If a taking co-producer claims an allowance for depletion on another co-producer's gas, the taking co-producer must reduce its deduction claimed in a later year for making a payment to the other co-producer for sales of that co-producer's gas by the amount of any percentage depletion deduction allowed on the gas sales to which the payment relates. If the percentage limitation of section 613A(d)(1) applied to disallow a depletion deduction for a previous year, the taking co-producer must reduce the amount of any carried over depletion deduction allowable in the year of the payment or in a future year by the portion of the carried over depletion deduction, if any, that relates to another co-producer's gas.

(C) *Addition to tax of taking co-producer for production credit claimed on another co-producer's gas.* If a taking co-producer claims a production credit on another co-producer's gas, the taking co-producer must add to its tax for the taxable year that it makes a payment to the other co-producer for sales of that co-producer's gas any production credit allowed in an earlier taxable year on the gas sales to which the payment relates, but only to the extent the credit allowed actually reduced the taking co-producer's tax in any earlier year. The taking co-producer also must reduce the amount of its minimum tax credit allowable by reason of section 53(d)(1)(B)(iii) in the year of the payment or in a future year by the portion of the credit, if any, that relates to another co-producer's gas.

(iv) *Anti-abuse rule.* If the Commissioner determines that co-producers using the cumulative method have arranged or altered their taking of production for a taxable year with a principal purpose of shifting the income, deductions, or credits relating to that production to avoid tax, the co-producers' election to be excluded from all or part of subchapter K will be revoked for that year and for subsequent years. In determining that a principal purpose was to avoid tax, the Commissioner will examine all the facts and circumstances surrounding the use of the cumulative method by the co-producers. See *Examples 3* and *4* of paragraph (d)(6) of this section.

(4) *Annual gas balancing method*—(i) *In general.* The annual gas balancing method (annual method) takes into account each co-producer's ownership rights and obligations, as described in the JOA, with respect to the co-producer's current proportionate share of gas as it is produced from the reservoir. Under the annual method, gas imbalances relating to a JOA must be eliminated annually through a balancing payment, which may be in the form of cash, gas produced under the same JOA,

or other property. If all the co-producers under a JOA have the same taxable year, any gas imbalance remaining at the end of a taxable year must be eliminated by a balancing payment from the overproducer to the underproducer by the due date of the overproducer's tax return for that taxable year (including extensions). If all the co-producers under a JOA do not have the same taxable year, any gas imbalance remaining at the end of a calendar year must be eliminated by a balancing payment from the overproducer to the underproducer by September 15 of the following calendar year. The annual method may be used only if the Commissioner's permission is obtained. Paragraph (d)(4)(ii) of this section provides guidelines for applying for this permission. The annual method is not available for a JOA with respect to which any co-producer made an election under paragraph (d)(5)(i)(B)(*3*) of this section (to take an aggregate section 481(a) adjustment for all JOAs of a co-producer into account in the year of change).

(ii) *Obtaining the Commissioner's permission to use the annual method.* A request for the Commissioner's permission to adopt the annual method for a new JOA must be in writing and must set forth the names of all the co-producers under the JOA and the respective taxable year of adoption. See paragraphs (d)(2)(ii) and (d)(5)(ii) of this section for the rules for a change in method of accounting to the annual method. In addition, the request must contain an explanation of how the co-producers will report income from gas sales, the making or receiving of a balancing payment, production expenses, depletion deductions, and production credits. Permission will be granted under appropriate conditions, including, but not limited to, an agreement in writing by all co-producers to use the annual method and to eliminate any gas imbalances annually in accordance with paragraph (d)(4)(i) of this section.

(5) *Transitional rules for making a change in method of accounting required in paragraph (d)(2)(ii)(C) of this section*—(i) *Change in method of accounting to the cumulative method*—(A) *Automatic consent to change in method of accounting to the cumulative method.* A co-producer changing to the cumulative method for any JOA entered into prior to its first taxable year beginning after December 31, 1994, and in effect as of the beginning of that year is granted the consent of the Commissioner to change its method of accounting with respect to each JOA to the cumulative method, provided the co-producer—

(*1*) Makes the change on its timely filed return for its first taxable year beginning after December 31, 1994;

(*2*) Attaches a completed and signed Form 3115 to the co-producer's tax return for the year of change, stating that, pursuant to § 1.761–2(d)(2)(ii) of the regulations, the co-producer is changing its method of accounting for sales of gas and its treatment of certain related deductions and credits under each JOA to the cumulative method;

(*3*) In the case of a co-producer making an election under paragraph (d)(5)(i)(B)(*3*) of this section to take the aggregate section 481(a) adjustment into account in the year of change, attaches the statement described in paragraph (d)(5)(i)(B)(*3*)(*ii*) of this section; and

(*4*) In the case of a co-producer not making an election under paragraph (d)(5)(i)(B)(*3*) of this section, attaches a list of each JOA with respect to which there is a section 481(a) adjustment computed in accordance with paragraph (d)(5)(i)(B)(*2*)(*i*) of this section.

(B) *Section 481(a) adjustment*—(*1*) *Application of section 481(a).* A change in method of accounting to the cumulative method under the automatic consent procedure in paragraph (d)(5)(i)(A) of this section is a change in method of accounting to which the provisions of section 481(a) apply. Thus, a section 481(a) adjustment must be taken into account in the manner provided by this paragraph (d)(5)(i)(B) to prevent the omission or duplication of income. Paragraph (d)(5)(i)(B)(*2*) of this section provides the general rules for computing the amount of the section 481(a) adjustment of a co-producer relating to a particular JOA and for taking the section 481(a) adjustment into account. Paragraph (d)(5)(i)(B)(*3*) of this section provides rules for electing to take a co-producer's section 481(a) adjustment computed on an aggregate basis for all JOAs into account in the year of change. Paragraph (d)(5)(i)(C) of this section provides rules to coordinate the taking of a depletion deduction or a production credit with the inclusion of a section 481(a) adjustment arising from a change in method of accounting to the cumulative method under this paragraph (d)(5)(i).

(*2*) *Computation of the section 481(a) adjustment relating to a joint operating agreement*—(*i*) *In general.* The section 481(a) adjustment of a co-producer relating to a JOA is computed as of the first day of the co-producer's year of change and is equal to the difference between the amount of income reported under the co-producer's former method of accounting for all taxable years prior to the year of change and the amount of income that would have been reported if the co-producer's new method had been used in all those taxable years.

(*ii*) *Section 481(a) adjustment period.* Except to the extent that paragraph (d)(5)(i)(B)(*3*) of this section applies, a co-producer's section 481(a) adjustment relating to a JOA, whether positive or negative, is taken into account in computing taxable income ratably over the 6-taxable-year period beginning with the year of change (the section 481(a) adjustment period). If the co-producer has been in existence less than 6 taxable years, the adjustment is taken into account over the number of years the co-producer has been in existence. If the co-producer ceases to engage in the trade or business that gave rise to the section 481(a) adjustment at any time during the section 481(a) adjustment period, the entire remaining balance of the section 481(a) adjustment relating to that trade or business must be taken into account in the year of the cessation. For purposes of this paragraph (d)(5)(i)(B)(*2*)(*ii*), production under each JOA is treated as a separate trade or business. The determination as to whether the co-producer ceases to engage in its trade or business is to be made under the principles of § 1.446–1(e)(3)(ii) and its underlying administrative procedures. For example, the permanent cessation of production under a co-producer's JOA constitutes the cessation of a trade or business of the co-producer. Accordingly, for the year that production under a JOA permanently ceases, the remaining balance of the section 481(a) adjustment relating to the JOA must be taken into account.

(*3*) *Election to take aggregate section 481(a) adjustment for all joint operating agreements into account in the year of change*—(*i*) *In general.* A co-producer may elect to take into account its section 481(a) adjustment, computed on an aggregate basis for all of its JOAs, whether negative or positive, in the year of change, provided the co-producer uses the cumulative method for all of its JOAs entered into prior to its first taxable year beginning after December 31, 1994, and in effect as of the beginning of that year. The aggregate section 481(a) adjustment of a co-producer is equal to the difference between the amount of income reported under the co-producer's former method of accounting for all taxable years prior to the year of change and the amount of income that would have been reported if the co-producer's new method had been used in all of those taxable years for all JOAs for which the co-producer changes its method of accounting. An

election made under this paragraph (d)(5)(i)(B)(*3*) is irrevocable. If any person who, together with another person, would be treated as a single taxpayer under section 41(f)(1) (A) or (B) makes an election under this paragraph (d)(5)(i)(B)(*3*), all persons within that single taxpayer group will be treated as if they had made an election under this paragraph (d)(5)(i)(B)(*3*) and, as such, will be irrevocably bound by that election. If a co-producer does not make an election under this paragraph, each JOA entered into prior to the start of its first taxable year beginning after December 31, 1994, and in effect as of the beginning of that year must be accounted for separately in computing the section 481(a) adjustment and taxable income of the co-producer for any year to which this paragraph (d) applies.

(*ii*) *Time and manner for making the election.* An election under this paragraph (d)(5)(i)(B)(*3*) is made by attaching a statement to the co-producer's timely filed return for its year of change indicating that the co-producer is electing under § 1.761–2(d)(5)(i)(B)(*3*) to take its aggregate section 481(a) adjustment into account in the year of change.

(C) *Treatment of section 481(a) adjustment as a sale for purposes of computing a production credit and as gross income from the property for purposes of depletion deductions.* Any positive section 481(a) adjustment arising as a result of a change in method of accounting for gas imbalances under this paragraph (d)(5)(i) and taken into account in computing taxable income under paragraph (d)(5)(i)(B) of this section is considered a sale by the taxpayer for purposes of computing any production credit in the year that the adjustment is taken into account. Similarly, the positive section 481(a) adjustment is considered *gross income from the property* and *taxable income from the property* for purposes of computing depletion deductions in the year the adjustment is taken into account. Sales amounts used in computing any production credit in any year in which a negative section 481(a) adjustment is taken into account in computing taxable income under paragraph (d)(5)(i)(B) of this section must be reduced by the amount of the negative section 481(a) adjustment taken into account in that year. Similarly, gross income from the property and taxable income from the property used in computing any depletion deduction in any year in which the negative section 481(a) adjustment is taken into account must be reduced by the amount of the negative adjustment. For these purposes, any taxpayer that makes an aggregate section 481(a) adjustment election under paragraph (d)(5)(i)(B)(*3*) of this section must allocate the adjustment among its properties in any reasonable manner that prevents a duplication or omission of depletion deductions.

(ii) *Change in method of accounting to the annual method*—(A) *In general.* A co-producer changing to the annual method in accordance with paragraph (d)(2)(ii) of this section must request a change under § 1.446–1(e)(3) and will be subject to any terms and conditions as may be imposed by the Commissioner.

(B) *Section 481(a) adjustment.* A change in method of accounting to the annual method is a change in method of accounting to which the provisions of section 481(a) apply. Thus, a section 481(a) adjustment must be taken into account to prevent the omission or duplication of income. If all the co-producers under a JOA have the same taxable year, the section 481(a) adjustment involved in a change to the annual method by a co-producer relating to the JOA is computed as of the first day of the co-producer's year of change. If the co-producers under a JOA do not all have the same taxable year (that is, in the case of a part-year change described in paragraph (d)(2)(ii)(C) of this section), the change in method of accounting occurs on January 1, 1996, and the section 481(a) adjustment is computed on that date.

(iii) *Untimely change in method of accounting to comply with this section.* Unless a co-producer required by this section to change its method of accounting complies with the provisions of this paragraph (d)(5) for its first applicable taxable year within the time prescribed by this paragraph (d)(5), the co-producer must take the section 481(a) adjustment into account under the provisions of any applicable administrative procedure that is prescribed by the Commissioner specifically for purposes of complying with this section. Absent such an administrative procedure, a co-producer must request a change under § 1.446–1(e)(3) and will be subject to any terms and conditions as may be imposed by the Commissioner.

(6) *Examples.* The following examples illustrate the application of the cumulative method described in paragraph (d)(3) of this section.

*Example 1. Operation of the cumulative method.* (i) L, a corporation using the cash receipts and disbursements method of accounting, and M, a corporation using an accrual method, file returns on a calendar year basis. On January 1, 1995, L and M enter into a JOA to produce natural gas as an unincorporated organization from a reservoir located in State Y. The JOA allocates reservoir production 60 percent to L and 40 percent to M. L and M enter into a GBA as an addendum to the JOA. L and M agree to use the cumulative method to account for gas sales from the reservoir and elect under section 761(a) and this section to exclude the organization from the application of subchapter K. Production from the reservoir is eligible for the section 29 credit for producing fuel from a nonconventional source. L and M produce and sell the following amounts of natural gas (in mmcf) until 2000 during which year production from the reservoir ceases:

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| L | 720 | 480 | 600 | –0– | –0– | –0– |
| M | 240 | 60 | 120 | 160 | 80 | 40 |

(ii) By the end of 1996, neither L nor M has fully produced its percentage share of the total gas in the reservoir. In 1997, L produces a total of 600 mmcf of gas at the rate of 50 mmcf per month. Prior to filing its return for 1997, L determines that it fully produced its percentage share of gas in the reservoir as of June 30, 1997. Pursuant to the GBA executed by L and M, L pays M at the end of 2000 for the 300 mmcf of M's gas (as determined under the cumulative method) that L sold in the last half of 1997.

(iii) For 1995, L and M must include in their gross income the amounts relating to gas sales of 720 mmcf and 240 mmcf, respectively. For 1996, L and M must include the amounts relating to gas sales of 480 mmcf and 60 mmcf, respectively. For both 1995 and 1996, L and M compute an allowance for depletion and a section 29 credit based upon gas taken and sold by each from the reservoir for each taxable year.

(iv) For 1997, L and M must include in gross income the amounts relating to their gas sales of 600 mmcf and 120 mmcf, respectively. Under paragraph (d)(3)(iii)(A) of this section, L computes an allowance for depletion and the section 29 credit based only on production from L's proportionate share of gas in the reservoir (that is, based on L's production through June 30, 1997). Accordingly, for 1997, L claims depletion and the section 29 credit only with respect to 300 mmcf of gas (50 mmcf per month x 6 months). For 1997, because M has not fully produced from its percentage share of the

total gas in the reservoir as of the end of 1997, M claims depletion and the section 29 credit on the 120 mmcf that M produced in 1997

(v) In 1998 and 1999, M must include in gross income the amounts relating to M's sales of gas, that is, 160 mmcf for 1998 and 80 mmcf for 1999. For 2000, M must include in gross income the amount relating to sales of 340 mmcf of gas, which consists of its own sales of 40 mmcf plus the payment for 300 mmcf of gas that L made to M for having sold from M's share of the total gas in the reservoir during the last half of 1997 Because M produced from its percentage share of the total gas in the reservoir during 1998, 1999, and 2000, M claims a depletion deduction and a section 29 credit on its income and production for those years, that is, 160 mmcf for 1998, 80 mmcf for 1999, and 40 mmcf for 2000. Additionally, for 2000, M claims depletion and the section 29 credit relating to the payment that M received from L for the 300 mmcf of M's gas that L sold in the last half of 1997 Under paragraph (d)(3)(ii)(B) of this section, L's deduction for its payment to M for the 300 mmcf of M's gas that L sold in 1997 is allowable only for 2000.

*Example 2. Adjustments under the cumulative method for depletion deductions and production credits that were claimed for sales in excess of a co-producer's percentage share of total gas in the reservoir.* (i) L, a corporation using the cash receipts and disbursements method of accounting, and M, a corporation using an accrual method, file returns on a calendar year basis. On January 1, 1995, L and M enter into a JOA to produce natural gas as an unincorporated organization from a reservoir located in State Y The JOA allocates reservoir production 60 percent to L and 40 percent to M. L and M enter into a GBA as an addendum to the JOA. L and M agree to use the cumulative method to account for gas sales from the reservoir and elect under section 761(a) and this section to exclude the organization from the application of subchapter K. Production from the reservoir is eligible for the section 29 credit for producing fuel from a nonconventional source. L and M produce and sell the following amounts of natural gas (in mmcf) until 2000 during which year production from the reservoir ceases:

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| L | 720 | 480 | 600 | 60 | 60 | –0– |
| M | 240 | 60 | 120 | 60 | 60 | 40 |

(ii) In addition, L does not realize until December 31, 1999, that L fully produced its percentage share of the total gas in the reservoir as of June 30, 1997. At the time of filing its returns for 1997 and 1998, L reasonably believes that during 1997 and 1998, respectively, it did not fully produce its percentage share of the total gas in the reservoir. Thus, L claims depletion and the section 29 credit for its total sales of 600 mmcf in 1997 and 60 mmcf in 1998. Pursuant to the GBA executed by L and M, L pays M at the end of 2000 for the 420 mmcf of M's gas (as determined under the cumulative method) that L sold (300 mmcf in the last half of 1997 (assuming that production was at a rate of 50 mmcf per month), 60 mmcf in 1998, and 60 mmcf in 1999).

(iii) In 1997 and 1998, L and M include in gross income the amounts relating to their respective sales of gas, that is, for L 600 mmcf for 1997 and 60 mmcf for 1998, and for M 120 mmcf for 1997 and 60 mmcf for 1998.

(iv) For 1999, L must include in gross income the amount of its sales of 60 mmcf, but may not claim depletion or the section 29 credit on those sales. For 1999, M must include in gross income the amount of its sales of 60 mmcf and claims depletion and the section 29 credit with respect to those 60 mmcf.

(v) For 2000, M must include in gross income the amount relating to gas sales of 460 mmcf, that is, the amount of M's own gas sales of 40 mmcf and the amount of the payment received from L for the 420 mmcf of M's gas that L sold (consisting of 300 mmcf in 1997, 60 mmcf in 1998, and 60 mmcf in 1999). Under paragraph (d)(3)(iii)(A) of this section, M computes a depletion deduction and a production credit relating to the amount of M's actual gas sales for 2000 and the payment received from L, that is, relating to a total of 460 mmcf of gas (M's sales of 40 mmcf for 2000, plus L's payment for 420 mmcf of gas). Under paragraph (d)(3)(ii)(B) of this section, L's deduction for making its payment to M for 420 mmcf of gas is allowable only for 2000. Under paragraph (d)(3)(iii)(B) of this section, L must reduce its deduction by the amount of any percentage depletion deductions allowed on its sales of M's gas, that is, relating to 360 mmcf of gas (300 mmcf for 1997 and 60 mmcf for 1998). In addition, under paragraph (d)(3)(iii)(C) of this section, L must increase its tax for 2000 by the amount of any section 29 credit L claimed on its sales of M's gas, but only to the extent that the credit claimed actually reduced L's tax in any earlier year.

*Example 3. Non-abusive altering of the taking of production for a taxable year.* (i) C and D enter into a JOA and a GBA on December 1, 1994, for gas production from a reservoir. The JOA allocates production at 50 percent to C and 50 percent to D. C and D agree in writing to use the cumulative method to account for gas sales. Additionally, C and D elect under section 761(a) and this section to exclude their organization from the application of subchapter K. C and D arrange to sell all their production under annually renewable contracts. In 1995, C and D each sell 480 mmcf of gas from the reservoir.

(ii) In November 1995, D is notified that its contract with its purchaser will not be renewed for 1996. D is unable to find a new purchaser for its gas for 1996. In December 1995, D notifies C that it will not be taking production from the reservoir in 1996. Pursuant to the GBA, C then contracts with its current gas purchaser to sell an additional 20 mmcf per month in 1996. Accordingly, C sells 720 mmcf in 1996 (60 mmcf per month x 12 months). Under the facts described in this example, a principal purpose of altering the taking of production is not to avoid tax. Accordingly, the co-producers' election under section 761(a) will not be revoked by reason of altering the taking of production.

*Example 4. Abusive altering of the taking of production for a taxable year.* The facts are the same as in *Example 3*(i). For 1996, C anticipates that C's regular tax (reduced by the credits allowable under sections 27 and 28) will not exceed C's tentative minimum tax. Accordingly, under section 29(b)(6), C's credit allowed under section 29(a) for sales of its gas will be zero. For 1997, C anticipates that its credit allowed under section 29(a) will not be limited by section 29(b)(6). On the other hand, D anticipates that any credit it may claim under section 29(a) for 1996, even including a credit based on sales of C's share of current production under the JOA, will not be limited by section 29(b)(6). However, for 1997, D anticipates that its credit under section 29(a) will be limited by section 29(b)(6). On January 1, 1996, C and D agree that D will contract with its purchaser to sell the entire 960 mmcf produced from the reservoir in 1996 and that C will contract with its purchaser to sell the entire 960 mmcf produced from the reservoir in 1997. Under these facts, a principal purpose of altering the taking of production is to avoid tax. Accordingly, the co-producers' election under section 761(a) will be revoked for 1996 and for subsequent years.

(7) *Effective date.* Except in the case of a part-year change to the annual method or the cessation of a JOA, both of which are described in paragraph (d)(2)(ii)(C) of this section, the provisions of this paragraph (d) apply to all taxable years beginning after December 31, 1994, of any producer that is a member of an unincorporated organization that produces natural gas under a JOA in effect on or after the start of the producer's first taxable year beginning after December 31, 1994. In the case of a part-year change, the provisions of this paragraph (d) apply on and after January 1, 1996. In the case of the cessation of a JOA, the co-producers use their current method of accounting with respect to that JOA until the JOA ceases to be in effect.

* * * * *

## PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

**Par. 3.** The authority citation for part 602 continues to read as follows:

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

§ 602.101 [Amended]

Par. 4. In § 602.101, paragraph (c) is amended by removing the existing entry for 1.761–2 and by adding the entry "1.761–2 * * * 1545–1338" in numerical order to the table.

**Margaret Milner Richardson,**

*Commissioner of Internal Revenue.*

Approved: December 12, 1994.

**Leslie Samuels,**

*Assistant Secretary of the Treasury.*

[FR Doc. 94–31291 Filed 12–22–94; 8:45 am]

BILLING CODE 4830–01–U

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**26 CFR Part 31**

**[TD 8582]**

**RIN 1545–AR08**

## Update of Railroad Retirement Tax Act Regulations

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations.

**SUMMARY:** This document contains final regulations relating to the Railroad Retirement Tax Act (RRTA). These regulations update the existing RRTA regulations by removing obsolete provisions and adding new provisions to reflect the statutory changes that have occurred since the publication in 1964 of the existing RRTA regulations. In addition, because Tier 1 of the RRTA mirrors the Federal Insurance Contributions Act (FICA), these regulations generally cross-reference the definition of compensation under the RRTA to the definition of wages under the FICA. The regulations provide both railroad employers and IRS personnel with the guidance necessary to comply with the law.

**DATES:** These regulations are effective December 23, 1994. These regulations apply for calendar years beginning after December 31, 1992.

**FOR FURTHER INFORMATION CONTACT:** Jean Whalen Casey at (202) 622–6040.

**SUPPLEMENTARY INFORMATION:**

### Background

On May 13, 1993, the IRS published in the **Federal Register** (58 FR 28366) proposed amendments to the Employment Tax Regulations (26 CFR part 31) under sections 3201 through 3231 of the Internal Revenue Code (Code).

Written comments were received from the public on the proposed regulations, and a public hearing was held on August 30, 1993. After consideration of all of the written comments received and the statements made at the public hearing, the proposed regulations are adopted as revised by this Treasury decision.

### Explanation of Revisions and Summary of Comments

The comments received focused on the definition of "employer" in § 31.3231(a)–1 and the definition of compensation in § 31.3231(e)–1.

Proposed Regulation § 31.3231(a)–1(c) describes the term "casual" as used in the phrase "casual service and the casual operation of equipment or facilities." Under the proposed regulations, the term "casual" applies, in part, whenever such service or operation is insubstantial. One commentator suggested the IRS adopt a bright line test in defining insubstantial. Specifically, the commentator suggested that service or operation of equipment or facilities in connection with the transportation of passengers or property by railroad be presumed to be insubstantial whenever less than 10% of any company's revenues, work force, or payroll are derived from, devoted to, or provided to the carrier or carriers affiliated with the company. Situations can arise where one of the factors is less than 10% while the remaining factors are greater than 10%. It is not clear that the service or operation of equipment or facilities would be insubstantial in those situations. Therefore, this suggestion was not adopted.

The proposed regulations define "compensation" under the RRTA by referencing the definition of "wages" under the FICA. One commentator suggested that this reference be deleted because the statutory language of the two statutes differs. This suggestion was not adopted. The definition of wages under the FICA refers to "all remuneration for employment" while the definition of compensation under the RRTA refers to "any money remuneration paid to an individual." The commentator stated that Congress had the opportunity to conform the language of the two definitions and has not done so. While there are historical differences between the two statutes, there are significant similarities between the RRTA and the FICA. Legislation enacted since the adoption of the existing regulations has made the RRTA Tier 1 tax identical to the FICA tax as well as conforming the Tier 1 wage ceiling to the FICA wage ceiling. Along with conforming the structure of the RRTA to parallel that of the FICA, the exclusions from the definition of compensation under the RRTA, with few exceptions, mirror the exclusions from the definition of wages under the FICA. These exclusions from compensation include non-monetary benefits such as fringe benefits, meals and lodging excludable under section 119 of the Internal Revenue Code, and employer-paid life insurance premiums for group-term life insurance under $50,000. In amending RRTA, Congress often indicated the purpose was to provide conformity to FICA. Congress has added references to FICA provisions in the RRTA definition of successor employer (section 3231(e)(2)(C)) and the rules for nonqualified deferred compensation (section 3231(e)(8)). In addition, Tier 1 benefits are designed to be equivalent to social security benefits and are subject to federal income taxation in the same manner as social security benefits. Because the two statutes are not completely identical, the language of the regulation indicates that the term compensation has the same meaning as the term wages, except as specifically limited by the Railroad Retirement Tax Act.

One commentator suggested that the presumption in § 31.3231(e)–1(a)(2) that payments made to an individual through the employer's payroll are compensation should be deleted. This is based on the removal of this language from the Internal Revenue Code in 1983. The commentator also suggested that § 31.3231(e)–1(a)(4) providing that compensation includes payments for time lost should be deleted. These provisions are included in the existing regulations. The Railroad Retirement Solvency Act of 1983 significantly amended the definition of compensation, changing the inclusion of items to a "paid basis" from an "earned basis" and providing the present two tiered structure. Prior to the 1983 Act, statutory language specifically provided for the presumption and the inclusion of payments for time lost. In amending the definition of compensation, the 1983 Act did not reenact the statutory language. The legislative history does not indicate that Congress intended to exclude payments for time lost from compensation or negate the presumption that payments made through an employer's payroll are compensation. Therefore, these suggestions were not adopted.

A suggestion was also made to delete the reference to "earned" in proposed § 31.3231(e)–1(a)(3). Because section 3231 was amended to shift the focus from when compensation was earned to when compensation was paid, this suggestion has been adopted.

Finally, one commentator suggested adding a reference that compensation does not include supplemental unemployment compensation benefits (SUB-pay). There is no specific statutory

exception from compensation for SUB-pay. Rather, a series of revenue rulings provides a limited exception from the definition of wages for purposes of FICA and FUTA for certain payments made upon an employee's involuntary separation from the employer's service, but only if the payments are designed to supplement the receipt of unemployment compensation. Rev. Rul. 56–249, 1956–1 C.B. 488, the first of many rulings in this area, summarized eight features of a SUB-pay plan whose payments qualified for exclusion from wage treatment. Rev. Rul. 90–72, 1990–2 C.B. 211, specifically provides that because the definition of compensation for RRTA purposes is similar to the definition of wages for FICA purposes, the same conclusions with respect to SUB-pay plans applies to RRTA. Rev. Rul. 90–72 revoked in part an earlier revenue ruling which held that SUB-pay does not have to be tied to state unemployment benefits in order to be excluded from treatment as wages. Because payments from a SUB-pay plan are not automatically excluded from the definition of compensation this suggestion was not adopted.

**Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 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) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

**Drafting Information**

The principal author of these regulations is Jean Whalen Casey of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

**List of Subjects in 26 CFR Part 31**

Employment taxes, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social security, Unemployment compensation.

**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 31 is amended as follows:

## PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

**Paragraph 1.** The authority citation for part 31 continues to read in part as follows:

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

**Par. 2.** Section 31.3121(a)–1 is amended as follows:

1. Paragraph (a) is redesignated as (a)(1).

2. Paragraph (a)(2) is added to read as follows:

**§ 31.3121(a)–1 Wages.**

(a) * * *

(2) The term *compensation* as used in section 3231(e) of the Internal Revenue Code has the same meaning as the term *wages* as used in this section, determined without regard to section 3121(b)(9), except as specifically limited by the Railroad Retirement Tax Act (chapter 22 of the Internal Revenue Code) or regulation. The Commissioner may provide any additional guidance that may be necessary or appropriate in applying the definitions of sections 3121(a) and 3231(e).

* * * * *

**Par. 3.** Sections 31.3201–1 and 31.3201–2 are revised to read as follows:

**§ 31.3201–1 Measure of employee tax.**

The employee tax is measured by the amount of compensation received for services rendered as an employee. For provisions relating to compensation, see § 31.3231(e)–1. For provisions relating to the circumstances under which certain compensation is to be disregarded for the purpose of determining the employee tax, see paragraphs (b)(1) and (2) of § 31.3231(e)–1.

**§ 31.3201–2 Rates and computation of employee tax.**

(a) *Rates*—(1)(i) *Tier 1 tax.* The Tier 1 employee tax rate equals the sum of the tax rates in effect under section 3101(a) relating to old-age, survivors, and disability insurance, and section 3101(b), relating to hospital insurance. The Tier 1 employee tax rate is applied to compensation up to the contribution base described in section 3231(e)(2)(B)(i). The contribution base is determined under section 230 of the Social Security Act and is identical to the old-age, survivors, and disability insurance wage base and the hospital insurance wage base, respectively, under the Federal Insurance Contributions Act.

(ii) *Example.* The rule in paragraph (a)(1)(i) of this section is illustrated by the following example.

*Example. A* received compensation of $60,000 in 1992. The section 3101(a) rate of 6.2 percent would be applied to *A*'s compensation up to $55,500, the applicable contribution base for 1992. The section 3101(b) rate of 1.45 percent would be applied to the entire $60,000 of *A*'s compensation because the applicable contribution base for 1992 is $130,200.

(2)(i) *Tier 2 tax.* The Tier 2 employee tax rate equals the percentage set forth in section 3201(b) of the Code. This rate is applied to compensation up to the contribution base described in section 3231(e)(2)(B)(ii).

(ii) *Example.* The rule in paragraph (a)(2)(i) of this section is illustrated by the following example.

*Example. A* received compensation of $60,000 in 1992. The section 3201(b) rate of 4.90 percent would be applied to *A*'s compensation up to $41,400, the applicable contribution base for 1992.

(b)(1) *Computation.* The employee tax is computed by multiplying the amount of the employee's compensation with respect to which the employee tax is imposed by the rate applicable to such compensation, as determined under paragraph (a) of this section. The applicable rate is the rate in effect when the compensation is received by the employee. For rules relating to the time of receipt, see § 31.3121(a)–2 (a) and (b).

(2) *Example.* The rule in paragraph (b)(1) of this section is illustrated by the following example.

*Example.* In 1990, employee *A* received compensation of $1,000 as remuneration for services performed for employer *B* in 1989. The employee tax is payable at the rate of 12.55 percent (7.65 percent plus 4.90 percent) in effect for 1990 (the year the compensation was received), and not the 12.41 percent rate (7.51 percent plus 4.90 percent) in effect for 1989 (the year the services were performed).

**Par. 4.** Section 31.3202–1 is amended by revising paragraphs (b) and (f) to read as follows:

**§ 31.3202–1 Collection of, and liability for, employee tax.**

* * * * *

(b) *Collection; payments by two or more employers in excess of annual compensation limitation.* For rules relating to payments by two or more employers in excess of the annual compensation limitation see § 31.3121(a)(1)–1.

* * * * *

(f) *Concurrent employment.* If two or more related corporations who are rail

employers concurrently employ the same individual and compensate that individual through a common paymaster, which is one of the related corporations employing the individual, see § 31.3121(s)–1.

**Par. 5.** Sections 31.3211–1 and 31.3211–2 are revised to read as follows:

**§ 31.3211–1 Measure of employee representative tax.**

The employee representative tax is measured by the amount of compensation received for services rendered as an employee representative. For provisions relating to compensation, see § 31.3231(e)–1.

**§ 31.3211–2 Rates and computation of employee representative tax.**

(a) *Rates*—(1)(i) *Tier 1 tax.* The Tier 1 employee representative tax rate equals the sum of the tax rates in effect under sections 3101(a) and 3111(a), relating to the employee and the employer tax for old-age, survivors, and disability insurance, and sections 3101(b) and 3111(b), relating to the employee and the employer tax for hospital insurance. The Tier 1 employee representative tax rate is applied to compensation up to the contribution base described in section 3231(e)(2)(B)(i). The contribution base is determined under section 230 of the Social Security Act, and is identical to the old-age, survivors, and disability insurance wage base and the hospital insurance wage base, respectively, under the Federal Insurance Contributions Act.

(ii) *Example.* The rule in paragraph (a)(1)(i) of this section is illustrated by the following example.

*Example. B,* an employee representative received compensation of $60,000 in 1992. The sections 3101(a) and 3111(a) rates of 12.4 percent (6.2 percent plus 6.2 percent) would be applied to *B*'s compensation up to $55,500, the applicable contribution base for 1992. The sections 3101(b) and 3111(b) rates of 2.9 percent (1.45 percent plus 1.45 percent) would be applied to the entire $60,000 of *B*'s compensation because the applicable contribution base for 1992 is $130,200.

(2) (i) *Tier 2 tax.* The Tier 2 employee representative tax rate equals the percentage set forth in section 3211(a)(2) of the Code. This rate is applied up to the contribution base described in section 3231(e)(2)(B)(ii).

(ii) *Example.* The rule in paragraph (a)(2)(i) of this section is illustrated by the following example.

*Example. B* received compensation of $60,000 in 1992. The section 3211(a)(2) rate of 14.75 percent would be applied to *B*'s compensation up to $41,400, the applicable contribution base for 1992.

(3) *Supplemental Annuity Tax.* The supplemental annuity tax for each work-hour for which compensation is paid to an employee representative for services rendered as an employee representative is imposed at the same rate as the excise tax imposed on every employer under section 3221(c). See also § 31.3211–3.

(b) (1) *Computation.* The employee representative tax is computed by multiplying the amount of the employee representative's compensation with respect to which the employee representative tax is imposed by the rate applicable to such compensation, as determined under paragraph (a) of this section. The applicable rate is the rate in effect when the compensation is received by the employee representative. For rules relating to the time of receipt, see § 31.3121(a)–2 (a) and (b).

(2) *Example.* The rule in paragraph (b)(1) of this section is illustrated by the following example.

*Example.* In 1990, employee representative *B* received $1,000 as remuneration for services performed for employer *R* in 1989. The employee representative tax is payable at the rate of 30.05 percent (15.30 percent plus 14.75 percent) in effect for 1990 (the year the compensation was received), and not the 29.77 percent rate (15.02 percent plus 14.75 percent) in effect for 1989 (the year the services were performed).

(c) (1) *Rule where compensation is received both as an employee representative and employee.* The following rule applies to an individual who renders service both as an employee representative and as an employee. The employee representative tax is imposed on compensation received as an employee representative under the rules described in § 31.3211–2. The employee tax is imposed on compensation received as an employee under the rules described in § 31.3201–2. However, if the total compensation received is greater than the applicable contribution base, the employee representative tax is imposed on the amount equal to the contribution base less the amount received for services rendered as an employee.

(2) *Example.* The rule in paragraph (c)(1) of this section is illustrated by the following example.

*Example. C* performed services both as an employee and an employee representative in 1992. *C* received compensation of $40,000 as an employee and $20,000 as an employee representative. *C*'s entire compensation of $40,000 is subject to tax under the rules described in § 31.3201–2. The amount of employee representative compensation subject to the section 3101(a) and the section 3111(a) rate is $15,500 ($55,500 – $40,000). The entire $20,000 is subject to the sections 3101(b) and 3111(b) rates since the combined compensation is less than $130,200, the applicable contribution base for 1992. The amount of the employee representative compensation subject to the section 3211(a)(2) rate is $1,400 ($41,400 – $40,000).

**Par. 6.** Section 31.3221–1 is amended as follows:

1. Paragraphs (a) and (b) are revised.
2. Paragraph (d) is removed.
3. The revisions read as follows:

**§ 31.3221–1 Measure of employer tax.**

(a) *General Rule*—The employer tax is measured by the amount of compensation paid by an employer to its employees. For provisions relating to compensation, see § 31.3231(e)-1. For provisions relating to the circumstances under which certain compensation is to be disregarded for purposes of determining the employer tax, see paragraphs (b) (1) and (2) of § 31.3231(e)–1.

(b) *Payments by two or more employers in excess of annual compensation limitation.* For rules relating to payments by two or more employers in excess of the annual compensation limitation, see § 31.3121(a)(1)–1.

* * * * *

**Par. 7.** Section 31.3221–2 is revised to read as follows:

**§ 31.3221–2 Rates and computation of employer tax.**

(a) *Rates*—(1)(i) *Tier 1 tax.* The Tier 1 employer tax rate equals the sum of the tax rates in effect under section 3111(a) relating to old-age, survivors, and disability insurance, and section 3111(b) relating to hospital insurance. The Tier 1 employer tax rate is applied to compensation up to the contribution base described in section 3231(e)(2)(B)(i). The contribution base is determined under section 230 of the Social Security Act and is identical to the old-age, survivors, and disability insurance wage base and the hospital insurance wage base, respectively, under the Federal Insurance Contributions Act.

(ii) *Example.* The rule in paragraph (a)(1)(i) of this section is illustrated by the following example.

*Example. R*'s employee, *A*, received compensation of $60,000 in 1992. The section 3111(a) rate of 6.2 percent would be applied to *A*'s compensation up to $55,500, the applicable contribution base for 1992. The section 3111(b) rate of 1.45 percent would be applied to the entire $60,000 of *A*'s compensation because the applicable contribution base for 1992 is $130,200.

(2)(i) *Tier 2 tax.* The Tier 2 employer tax rate equals the percentage set forth in section 3221(b) of the Internal Revenue Code. This rate is applied up

to the contribution base described in section 3231(e)(2)(B)(ii).

(ii) *Example.* The rule in paragraph (a)(2)(i) of this section is illustrated by the following example.

*Example.* *R*'s employee, *A*, received compensation of $60,000 in 1992. The section 3221(b) rate of 16.10 percent would be applied to *A*'s compensation up to $41,400, the applicable contribution base for 1992.

(3) *Supplemental Annuity Tax.* The supplemental annuity tax for each work-hour for which compensation is paid by an employer for services rendered during any calendar quarter by employees is imposed at the tax rate determined each calendar quarter by the Railroad Retirement Board. See also § 31.3221–3.

(b)(1) *Computation.* The employer tax is computed by multiplying the amount of the compensation with respect to which the employer tax is imposed by the rate applicable to such compensation, as determined under paragraph (a) of this section. The applicable rate is the rate in effect at the time the compensation is paid. For rules relating to the time of payment, see § 31.3121(a)–2(a) and (b).

(2) *Example.* The rule in paragraph (b)(1) of this section is illustrated by the following example.

*Example.* In 1990, *R*'s employee *A* received $1,000 as remuneration for services performed for *R* in 1989. The employer tax is payable at the rate of 23.75 percent (7.65 percent plus 16.10 percent) in effect for 1990 (the year the compensation was received) and not the 23.61 percent rate (7.51 percent plus 16.10 percent) in effect for 1989 (the year the services were performed).

**Par. 8.** Section 31.3231(a)–1 is amended as follows:

1. Paragraph (a)(1) is revised.
2. Paragraphs (c) and (d) are redesignated as (d) and (e).
3. Paragraphs (c) and (f) are added.
4. The revisions and additions read as follows:

**§ 31.3231(a)–1 Who are employers.**

(a) * * *

(1) Any carrier, that is, any express carrier, sleeping car carrier, or rail carrier providing transportation subject to subchapter I of chapter 105 of title 49;

* * * * *

(c) As used in paragraph (a)(2) of this section, the term *casual* applies when the service rendered or the operation of equipment or facilities by a controlled company or person in connection with the transportation of passengers or property by railroad is so irregular or infrequent as to afford no substantial basis for an inference that such service or operation will be repeated, or whenever such service or operation is insubstantial.

* * * * *

(f) Any company that is described in paragraph (a)(2) of this section is an employer under section 3231. In certain cases, based on all the facts and circumstances, it may be appropriate to segregate those businesses engaged in rail services and therefore subject to the Railroad Retirement Tax Act from those businesses engaged exclusively in nonrail services and therefore not subject to the Railroad Retirement Tax Act. The factors considered are set forth in guidance published by the Internal Revenue Service.

**Par. 9.** Section 31.3231(e)–1 is revised to read as follows:

**§ 31.3231(e)–1 Compensation.**

(a) *Definition*—(1) The term *compensation* has the same meaning as the term *wages* in section 3121(a), determined without regard to section 3121(b)(9), except as specifically limited by the Railroad Retirement Tax Act (chapter 22 of the Internal Revenue Code) or regulation. The Commissioner may provide any additional guidance that may be necessary or appropriate in applying the definitions of sections 3121(a) and 3231(e).

(2) A payment made by an employer to an individual through the employer's payroll is presumed, in the absence of evidence to the contrary, to be compensation for services rendered as an employee of the employer. Likewise, a payment made by an employee organization to an employee representative through the organization's payroll is presumed, in the absence of evidence to the contrary, to be compensation for services rendered by the employee representative as such. For rules regarding the treatment of deductions by an employer from remuneration of an employee, see § 31.3123–1.

(3) The term *compensation* is not confined to amounts paid for active service, but includes amounts paid for an identifiable period during which the employee is absent from the active service of the employer and, in the case of an employee representative, amounts paid for an identifiable period during which the employee representative is absent from the active service of the employee organization.

(4) Compensation includes amounts paid to an employee for loss of earnings during an identifiable period as the result of the displacement of the employee to a less remunerative position or occupation as well as pay for time lost.

(5) For rules regarding the treatment of reimbursement and other expense allowance amounts, see § 31.3121(a)–3. For rules regarding the inclusion of fringe benefits in compensation, see § 31.3121(a)–1T.

(b) *Special Rules.* (1) If the amount of compensation earned in any calendar month by an individual as an employee in the service of a local lodge or division of a railway-labor-organization employer is less than $25, the amount is disregarded for purposes of determining the employee tax under section 3201 and the employer tax under section 3221.

(2) Compensation for service as a delegate to a national or international convention of a railway-labor-organization employer is disregarded for purposes of determining the employee tax under section 3201 and the employer tax under section 3221 if the individual rendering the service has not previously rendered service, other than as a delegate, which may be included in the individual's years of service for purposes of the Railroad Retirement Act.

(3) For special provisions relating to the compensation of certain general chairs or assistant general chairs of a general committee of a railway-labor-organization employer, see paragraph (c)(3) of § 31.3231(b)–1.

**Par. 10.** Section 31.3231(e)–2 is added to read as follows:

**§ 31.3231(e)–2 Contribution base.**

The term compensation does not include any remuneration paid during any calendar year by an employer to an employee for services rendered in excess of the applicable contribution base. For rules applying this provision, see § 31.3121(a)(1)–1

**§§ 31.3231(e)–2T and 31.3231(e)–3 [Removed]**

**Par. 11.** Sections 31.3231(e)–2T and 31.3231(e)–3 are [Removed]

**Margaret Milner Richardson,**

*Commissioner of Internal Revenue*

Approved November 28, 1994

**Leslie Samuels,**

*Assistant Secretary of the Treasury*

[FR Doc 94–31426 Filed 12–22–94, 8:45 am]

BILLING CODE 4830–01–U

26 CFR Part 301

[TD 8583]

RIN 1545–AM66

## Agreements for Payment of Tax Liabilities in Installments

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations.

**SUMMARY:** This document contains final regulations regarding agreements for the payment of federal tax liabilities in installments under section 6159 of the Internal Revenue Code of 1986. These regulations reflect changes to the law made by section 6234 of the Technical and Miscellaneous Revenue Act of 1988 (TAMRA) (Pub. L. 100–647, 102 Stat. 3573), which authorizes the use of written installment agreements if the Secretary determines that an installment agreement will facilitate collection of federal tax liabilities. These regulations affect persons who wish to enter into agreements to pay their tax liability in installments.

**EFFECTIVE DATE:** December 23, 1994.

**FOR FURTHER INFORMATION CONTACT:** Kevin Connelly, (202) 622–3640 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

### Background

On December 2, 1993, a notice of proposed rulemaking was published in the **Federal Register** (56 FR 63541). No public hearing was requested or held.

Written comments responding to the notice were received. After consideration of all the comments, the proposed regulations are adopted as revised by this Treasury decision.

### *Explanation of Revisions and Summary of Comments*

An explanation of the regulations is contained in the preamble of the notice of proposed rulemaking, published in the **Federal Register** (56 FR 63541) on December 2, 1993. The following is an explanation of the comments that were received and the revisions that were made in response to the comments.

The proposed regulations authorize the IRS to alter, modify, or terminate an installment agreement if a district director, a director of a service center, or a director of a compliance center (the director) determines that the financial condition of the taxpayer has significantly improved. Two commenters have suggested amending this provision to also authorize the IRS to alter or modify an agreement if the taxpayer's financial condition has deteriorated.

The provision in the proposed regulations is intended to prohibit the IRS from amending or terminating an installment agreement unilaterally if a taxpayer's financial condition has deteriorated as long as the taxpayer continues to make timely payments. In order to preserve this prohibition and at the same time respond to the commenters' concern, a new provision has been added to the final regulations which allows the director, upon request by a taxpayer, to amend or terminate an installment agreement because of a deterioration (or other change) in the taxpayer's financial condition.

The proposed regulations require the IRS to give notice at least 30 days prior to altering, modifying, or terminating an installment agreement. One commenter has suggested that the IRS also should be required to give the taxpayer a 30-day written notification of any intent to deny an agreement and the opportunity to appeal. The Internal Revenue Code does not require the IRS to give 30 days notice of its intent to deny an installment agreement. Such a notice requirement would enable taxpayers to stop collection actions for 30 days simply by requesting an installment agreement. For these reasons, the commenters' suggestion has not been adopted.

The proposed regulations provide that a written installment agreement may take the form of a document signed by the taxpayer and the director or a written confirmation of a verbal agreement entered into by the taxpayer and the IRS. A commenter has suggested that written installment agreements should be allowed only on standardized forms such as Forms 433–D or 9465, because agreements other than those on standardized forms may cause confusion or abuse.

The IRS enters into two types of installment agreements. Written agreements on Forms 433–D, 433–G, and 2159, which are negotiated face-to-face, are generally based on an exhaustive, written financial statement, and are signed by both the taxpayer and an employee of the IRS who has "examined or approved" the agreement. Other agreements are entered into by the Automated Collection System (ACS), the Service Center Collection Branch (SCCB), or Taxpayer Services (TS) either over the telephone or in response to a letter from a taxpayer. The agreements entered into by ACS, SCCB, or TS, which are neither negotiated face-to-face nor based on an in-depth examination of the taxpayer's financial condition, are confirmed in a letter from the IRS. The confirmation letter is signed by the IRS but not by the taxpayer.

A provision requiring all written installment agreements to be on standardized forms signed by both parties would severely hamper the ability of ACS, SCCB, and TS to enter into installment agreements. The ACS, SCCB, and TS are bulk processing centers where installment agreements generally are entered into on the basis of a single contact with the taxpayer. If installment agreements entered into by ACS, SCCB, or TS had to be on standardized forms signed by both the IRS and the taxpayer, finalization of each agreement would have to be monitored by the ACS, SCCB, or TS contact employee, or by some other employee. Once an agreement were made, a confirmation letter would have to be forwarded to the taxpayer for signature. If the confirmation letter were not returned in a timely manner, the employee would have to send a follow-up letter. Once a signed letter were returned, the employee would have to associate the letter with the taxpayer's file, fill out proper paperwork, and perhaps send a final follow-up letter to the taxpayer. This would defeat the very purpose of bulk processing.

Although the agreements entered into by ACS, SCCB, and TS are not on Forms 433–D, 433–G, or 9465, the confirmation letters sent by ACS, SCCB, and TS are based on model letters drafted by the IRS for the purpose of setting forth what is expected of the taxpayer. These letters, which set forth the terms of payment and the conditions on which the agreement is based, contain essentially the same information as the installment agreement forms. Therefore, there should be little or no confusion caused by the confirmation letters.

Although a provision requiring all installment agreements to be on standardized forms has not been adopted, the final regulations have been amended to allow installment agreements to take the form of a written confirmation of an agreement proposed in writing by the taxpayer and accepted by the IRS, as well as a written confirmation of a verbal agreement entered into between the taxpayer and the IRS.

A commenter has suggested that the proposed regulations be amended to make it clear that the IRS must give a 30-day notice of an intent to alter, modify, or terminate an agreement in all cases except where collection of the liability to which the installment agreement applies is in jeopardy. This suggestion has been adopted.

It also has been suggested that the regulations should state explicitly that

during the 30-day period the taxpayer may cure a default, correct inaccurate information, or provide additional information which will generally allow continuation of the original agreement. However, the reason for requiring written notification of an intent to alter, modify, or terminate an agreement is to give taxpayers the opportunity to show that the IRS has made a mistake. For example, if the IRS intends to terminate an agreement because it believes the taxpayer has given the IRS incorrect or incomplete information, the taxpayer will have thirty days to prove to the IRS that the taxpayer's information was correct and complete. The reason for the notification is not to allow the taxpayer to cure a default by correcting inaccurate information that the taxpayer gave the IRS during negotiations for an installment agreement. The regulations have been amended to provide that upon receiving notification that the IRS intends to alter, modify, or terminate an agreement the taxpayer may provide information to show that the IRS has made a mistake.

**Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 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) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

**Drafting Information**

The principal author of these regulations is Kevin Connelly, Office of Assistant Chief Counsel (General Litigation), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

**List of Subjects in 26 CFR Part 301**

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 301 is amended as follows:

## PART 301—PROCEDURE AND ADMINISTRATION

**Paragraph 1.** The authority citation for part 301 continues to read in part as follows:

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

**Par. 2.** Section 301.6159–1 is added under the undesignated center heading "Place and Due Date for Payment of Tax" to read as follows:

**§ 301.6159–1 Agreements for payment of tax liability in installments.**

(a) *Authority and definition.* A district director, a director of a service center, or a director of a compliance center (the director) is authorized to enter into a written agreement with a taxpayer that allows the taxpayer to satisfy a tax liability by making scheduled periodic payments until the liability is fully paid if the director determines that such an installment agreement will facilitate the collection of the tax liability.

(b) *Acceptance, form, and term of installment agreement*—(1) (i) *Acceptance or rejection of installment agreement.* The director has the discretion to accept or reject any proposed installment agreement. As a condition to entering into an installment agreement with a taxpayer, the director may require that—

(A) The taxpayer agree to a reasonable extension of the period of limitations on collection; and

(B) The agreement contain terms and conditions that protect the interests of the government.

(ii) *Example.* The director may require that a taxpayer authorize direct debit bank transfers as the method of making installment payments under the agreement.

(2) *Form of installment agreement.* A written installment agreement may take the form of a document signed by the taxpayer and the director or a written confirmation of an agreement entered into by the taxpayer and the director that is mailed or personally delivered to the taxpayer.

(3) *Term of accepted installment agreement.* Except as otherwise provided in this section, an installment agreement is effective from the day the director signs the agreement to the day the agreement ends by its terms.

(c) *Alteration, modification, or termination of installment agreements by the Internal Revenue Service*—(1) *Inadequate information or jeopardy* The director may terminate an installment agreement if—

(i) The director determines that the taxpayer or the taxpayer's representative has provided to the Internal Revenue Service information that is inaccurate or incomplete in any material respect in connection with the granting of the installment agreement; or

(ii) The director determines that collection of any tax liability to which the installment agreement applies is in jeopardy.

(2) *Subsequent change in financial condition, failure to timely pay an installment or another Federal tax liability, or failure to provide requested financial information.* The director may alter, modify, or terminate the terms of an installment agreement if—

(i) The director determines that the financial condition of a taxpayer that is a party to the installment agreement has significantly improved; or

(ii) The taxpayer that is a party to the installment agreement fails—

(A) To timely pay any installment in accordance with the terms of the installment agreement;

(B) To pay any other Federal tax liability when the liability becomes due; or

(C) To provide updated financial information requested by the director.

(3) *Request by taxpayer.* Upon request by a taxpayer that is a party to the installment agreement, the director may alter, modify, or terminate the terms of an installment agreement if the director determines that the financial condition of the taxpayer has significantly changed.

(4) *Notice.* Unless the director determines that collection of the tax is in jeopardy, the director will notify the taxpayer in writing at least 30 days before altering, modifying, or terminating an installment agreement pursuant to paragraph (c)(1) or (2) of this section. A notice provided pursuant to this paragraph must briefly describe the reason for the intended alteration, modification, or termination. Upon receiving notice, the taxpayer may provide information showing that the reason for the intended alteration, modification, or termination is incorrect.

(d) *Actions by the Internal Revenue Service during the term of the installment agreement.* Except as otherwise provided by the installment agreement, during the term of the agreement the director may take actions to protect the interests of the government with regard to the unpaid balance of the tax liability to which the installment agreement applies (other than actions pursuant to subchapter D of chapter 64 of subtitle F of the Internal Revenue Code against a person that is a party to the agreement), including any actions enumerated in the agreement. The actions include, for example—

(1) Requesting updated financial information from any party to the agreement;

(2) Conducting further investigations (including the issuance and enforcement of summonses) in connection with the tax liability to which the installment agreement applies;

(3) Filing or refiling notices of federal tax lien; and

(4) Taking collection action against any person who is not a party to the agreement but who is liable for the tax to which the agreement applies.

(e) *Termination.* If an installment agreement is terminated by the director, the director may pursue collection of the unpaid balance of the tax liability.

(f) *Cross-reference.* Pursuant to section 6601(b)(1), the last day prescribed for payment is determined without regard to any installment agreement, including for purposes of computing penalties and interest provided by the Internal Revenue Code.

(g) *Effective date.* This section is effective December 23, 1994.

**Margaret Milner Richardson,**

*Commissioner of Internal Revenue.*

Approved: November 28, 1994.

**Leslie Samuels,**

*Assistant Secretary of Treasury.*

[FR Doc. 94-31425 Filed 12-22-94; 8:45 am]

BILLING CODE 4830-01-U

## DEPARTMENT OF THE INTERIOR

## Office of Surface Mining Reclamation and Enforcement

## 30 CFR Part 950

## Wyoming Permanent Regulatory Program

**AGENCY:** Office of Surface Mining Reclamation and Enforcement (OSM), Interior.

**ACTION:** Final rule; approval of extension to timetable for enactment of required program amendments.

**SUMMARY:** OSM is announcing the Director's decision to extend time frames for the State of Wyoming to enact required program amendments to its permanent regulatory program (hereinafter referred to as the Wyoming program) under the Surface Mining Control and Reclamation Act. OSM did not approve Wyoming's previously proposed amendment to revise and add rules and statutes pertaining to definitions and revegetation success standards in the January 24, 1994, **Federal Register** (59 FR 3521). In that decision OSM required Wyoming to submit proposed program amendments to these statutes and rules by March 25, 1994.

**EFFECTIVE DATE:** December 23, 1994.

**FOR FURTHER INFORMATION CONTACT:** Guy V. Padgett, Telephone: (307) 261-5776.

**SUPPLEMENTARY INFORMATION:**

### I. Background on the Wyoming Program

On November 26, 1980, the Secretary of the Interior conditionally approved the Wyoming program. General background information on the Wyoming program, including the Secretary's findings, the disposition of comments, and conditions of approval of the Wyoming program can be found in the November 26, 1980, **Federal Register** (45 FR 78637). Subsequent actions concerning Wyoming's program and program amendments can be found at 30 CFR 950.11, 950.12, 950.15 and 950.16.

### II. Submission of Extension Request

By letter dated February 28, 1994, Wyoming submitted, consistent with the requirements at 30 CFR 732.17(f)(1), a description of a proposed amendment and a timetable for its enactment. The proposed timetable in the submission provided that Wyoming would have until the end of calendar year 1994 to complete the enactment of the proposed amendment (Administrative Record No. WY-26-1). In the letter, Wyoming notified OSM that the unusually lengthy timetable was needed to complete rulemaking regarding the required State program amendments at 30 CFR 950.16 (bb) through (gg). Since its February 28 submission of the proposed amendment and timetable for its enactment, Wyoming has been successful in drafting and receiving legislature approval of the required statutory changes as described at 30 CFR 950.16 (bb), (cc), (dd), (ee), and (ff). The statutory changes were signed by the Governor and filed with the Secretary of State on March 16, 1994. Wyoming, in its February 28 letter, asserts that it has been in "negotiated rule making" with all interested parties, including representatives from State, coal industry, and environmental groups, regarding the rule (non-statutory) portions of the required amendments that address specific shrub density standards for reclamation. Wyoming asserts that the "negotiated rule making" process, and the subsequent formal rulemaking process, are the reasons for the lengthy timetable in this submission.

OSM published a notice, in the March 21, 1994, **Federal Register** (59 FR 13286), announcing receipt of the Wyoming's February 28, 1994, letter and in the same notice requested public comment as to whether the proposed timetable should be approved. The public comment period closed on April 20, 1994.

By letter dated September 1, 1994, (Administrative Record No. WY-26-7), Wyoming submitted a request for additional time to complete rulemaking regarding the required State program amendments. This request would delay the resubmittal date of March 25, 1994, until November 1995. Wyoming informed OSM that, since the time of the initial submission, its Attorney General's Office had identified conflicts between the proposed statutes and "negotiated" rules and existing statutes and rules. This conflict, asserted Wyoming, had prohibited the State from proceeding with its formal rulemaking. Wyoming further asserted that statute changes that would eliminate the conflicts and allow Wyoming to proceed with formal rulemaking are currently being considered by the Wyoming Mining and Mineral Legislative committee. The statute changes cannot be considered by the entire Wyoming legislature, asserted Wyoming, until the State of Wyoming's next legislative session beginning in January 1995. The formal rulemaking, asserted Wyoming, could only proceed after successful legislative action and the Governor's approval of the statute changes.

OSM published a notice in the September 20, 1994, **Federal Register** (50 FR 48192), announcing receipt of the timetable extension request and in the same notice reopened the public comment period requesting written comments on the proposed request. The public comment period closed on October 5, 1994.

### III. Director's Findings

Set forth below, pursuant to the Surface Mining Control and Reclamation Act of 1977, 30 U.S.C. 1201-1328 (SMCRA) and the Federal regulations at 30 CFR 732.15 and 732.17, are the Director's findings concerning the proposed timetable for enactment submitted on February 28, 1994, and the subsequent request to extend that timetable submitted on September 1, 1994.

By letter submitted February 28, 1994, Wyoming proposed a timetable for enactment of required program amendments at 30 CFR 950.16 (bb) through (gg). That timetable extended until the end of calendar year 1994. The length of the timetable, according to Wyoming, resulted from a time consuming "negotiated rulemaking"

that the State was conducting in cooperation with State, coal industry, and environmental groups.

By its letter dated September 1, 1994, Wyoming requested an extension to the timetable for enactment of the required program amendments at 30 CFR 950.16 (bb) through (gg). The extension, asserted Wyoming, was needed to allow the State Legislature time to change existing statutes that conflicted with the proposed rules resulting from Wyoming's "negotiated rulemaking" effort with State, coal industry, and environmental groups. Wyoming informed OSM that, at the conclusion of the legislative session, the formal rulemaking process would proceed and that Wyoming expected to enact the 1994 statute changes, the revised rules, and any additional changes to the statutes that might be required to satisfy OSM's required program amendments at 30 CFR 950.16 (bb) through (gg). Wyoming informed OSM that the "negotiated rulemaking" with State, coal industry, and environmental groups referred to in its February 28, 1994, letter had been completed and that the extension to its original timetable was needed to implement the results of that rulemaking.

The required amendments concern Wyoming Statute (W.S.) 35–11–103(e)(xxviii) definition of "Agricultural lands"; W.S. 35–11–103(e)(xxix) definition of "Critical habitat"; W.S. 35–11–103(e)(xxx) definition of "Important habitat or critical habitat"; W.S. 35–11–402(b) provisions that direct Wyoming to use specific statutory definitions; W.S. 35–11–402(c) grazingland reclamation success standards; and the Department of Environmental Quality—Land Quality Division (DEQ/LQD) Rules at Chapter IV, Section 2(d)(x)(E) and Appendix A, pertaining to revegetation success standards for shrubs, as discussed in detail in the January 24, 1994, **Federal Register** (59 FR 3521).

OSM Directive REG–5 (Processing of Proposed State Regulatory Programs, Amendments and Part 732 Notifications) provides several factors to be considered in reviewing a proposed timetable for enactment of a required amendment or a subsequent proposed change to a timetable for enactment of a required amendment. These factors include: (1) The State's amendment process and constraints imposed by the State administrative and legislative rulemaking requirements, schedules and procedures; (2) the criticality of the amendment and/or portion of the State program to be amended, including any potential impacts on public health and safety or the environment; (3) the suitability of State promulgation of emergency regulations when the need for a program amendment is immediate; (4) the complexity of the amendment's subject matter and the nature of the change to be made, i.e., does the section of the program being amended "stand alone," or will change (or lack thereof) affect multiple sections of the State's program; (5) State workload factors; and (6) the possibility of combination with other amendments in related subject areas which are already scheduled under an improved timetable for enactment.

*Factor 1*

Wyoming's rulemaking process is quite complex and time consuming. In addition, Wyoming's administrative and legislative rulemaking requirements, schedules, and procedures are quite constraining. In Wyoming, the following steps are required for promulgation of a rule change:

(1) DEQ prepares draft rule;
(2) DEQ presents draft rule to an Advisory Board;
(3) DEQ modifies draft rule if required by the Advisory Board;
(4) DEQ requests concurrence from the Governor and Attorney General (AG) to proceed with adoption of draft rule;
(5) DEQ receive concurrence from Governor and AG;
(6) DEQ modifies draft rule if required by Governor and/or the AG;
(7) DEQ sends copies of draft rule to the Environmental Quality Council (EQC) with request for a hearing;
(8) Public notice of the hearing is published and a 45 day comment period on the draft rule occurs before EQC hearing;
(9) Comments on draft rule are analyzed by DEQ and DEQ modifies draft rule, if needed;
(10) EQC conducts hearing and decides to reject, adopt or modify draft rule;
(11) The Land Quality Division (LQD) submits EQC's decision to the AG and Legislative Service Office (LSO) within 10 days following announcement of decision of EQC;
(12) Within 30 days of decision, EQC issues a statement of reasons for overruling any public comment objections, if applicable;
(13) AG, with LSO concurrence, submits draft rule to Governor for approval; and,
(14) If Governor approves draft rule, the draft rule is forwarded to the Secretary of State's Office, within 60 days of approval, for filing.

In this instance, Wyoming asserts that the State rulemaking process has been stalled after the AG's office determination that the proposed, negotiated rules are in conflict with existing Wyoming Statute (W.S.) 35–11–402 (b) and (c). These statutes address consultation and approval requirements by State wildlife agencies. Wyoming State law prohibits Wyoming from promulgating rules that are in direct conflict with existing statutes. Thus, Wyoming's rulemaking process cannot proceed until the statutes are changed in the next legislative session. This would extend the timetable for the enactment of this amendment package to as late as November 1995, according to Wyoming.

*Factor 2*

The proposed amendment does not appear to present a potential impact to public health and safety. However, the proposed amendment does impact the environment because it concerns a revegetation success standard that is part of Wyoming's existing approved program and that has been determined to be less effective than the Federal program requirements. The State has already repealed portions of the statutes, negotiated proposed rules, and drafted statutory changes to resolve conflicts between those statutes and rules and the existing statutes. Thus, it is apparent that the State has determined these required amendments to be critical and is correcting them as expeditiously as possible.

*Factor 3*

The proposed amendment does not qualify as an emergency and it does not present potential impacts to public health and safety.

*Factor 4*

The complexity of the shrub reclamation amendment is evident by the divergent professional opinions regarding the appropriate minimum stocking rate and planting arrangements. The proposed change will affect multiple sections of the State's program concerning reclamation requirements.

*Factor 5*

The State has not shown that workload is a factor in considering this proposed extension.

*Factor 6*

The required program amendments at 30 CFR 950.16 (bb) through (ff) appear to have been addressed in the last Wyoming legislative session. The remaining required program amendment at 30 CFR 950.16(gg) is in "negotiated rulemaking," which will be followed by formal rulemaking and promulgation. Wyoming has requested that 30 CFR 950.16 (bb) through (gg) be submitted in one amendment package due to relationship of the subject matter. OSM agrees with the State on this approach.

Based on review of the above factors, the Director is approving Wyoming's February 28, 1994, proposed timetable for enactment, as revised by Wyoming's September 1, 1994, request for extension of that timetable. The timetable, as

revised, will allow Wyoming to enact the required program amendments specified at 30 CFR 950.16 (bb) through (gg). The timetable, as revised, extends through November 30, 1995. OSM has determined that this timetable will provide Wyoming the necessary time to allow for required legislative changes and public participation in their formal rulemaking process. OSM will monitor Wyoming's progress. Should the process break down and prohibit Wyoming from proceeding with the promulgation of the required program amendments within the time frame proposed in this rulemaking action. OSM will take immediate and appropriate action.

## IV. Summary and Disposition of Comments

*Public Comments*

The Director solicited public comments on the initial proposed timetable and the request to extend the proposed timetable. Written comments were received during both comment periods from the National Wildlife Federation (NWF), the Wyoming Wildlife Federation (WWF), and the Wyoming Outdoor Council (WOC) in letters dated April 19, 1994, and October 4, 1994, (Administrative Records Nos. WY–26–03 and WY–26–09). In both letters, the commenters collectively expressed concerns that the proposed extension is in violation of the regulations implementing SMCRA, questioned the 60-day time frame for renegotiating "minor changes to the proposed shrub density rule in response to the adopted legislation," and had concern with the unexplained additional 60–90 days to submit the proposed rules to OSM after the Environmental Quality Council's approval.

In the January 24, 1994, **Federal Register**, OSM did not approve a previously submitted proposed amendment from Wyoming and codified required program amendments at 30 CFR 950.16 (bb) through (gg) that were all inclusive to the proposed amendment. In accordance with 30 CFR 732.17(f)(1), the State had 60 days after notification to submit a written amendment or a description of an amendment along with a timetable for enactment. Therefore, the State's response was required by March 24, 1994. The State submitted a letter on February 28, 1994, which, by reference to an earlier, informal submittal of February 4, 1994, included a description of a proposed amendment. In addition, the February 28, 1994, letter included a proposed timetable for enactment of the proposed amendment. The proposed timetable extended through the end of calendar year 1994. In the February 28, 1994, letter, Wyoming discussed the then current "negotiated rulemaking" and the 1994 legislative action previously discussed as the reason for the unusually lengthy proposed timetable.

Thus, although characterized by the State and OSM as a "request for extension of time," Wyoming's February 28, 1994, letter, was, in fact, a description of a proposed amendment and a timetable for its enactment, submitted within the 60 day deadline at 30 CFR 732.17(f)(1).

The commenters asserted that OSM violated 30 CFR 732.17(h)(8) by allowing 60 days to submit new amendments. The Federal regulation at 30 CFR 732.17(h)(8) allows a State regulatory authority (RA) to resubmit a revised amendment within 30 days after publication of the disapproval.

As stated above, OSM did not approve the proposed amendment and required additional amendments, pursuant to the process at 30 CFR 732.17(f)(1), to remedy existing deficiencies in the Wyoming program discovered during that review. As discussed above, Wyoming complied with OSM's required amendment by submitting a description of an amendment and a timetable for its enactment within 60 days. Thus, neither OSM nor Wyoming acted inappropriately in this instance.

In stating that OSM should have given Wyoming only 30 days, rather than 60 days, in which to respond to OSM's required amendment, the commenters appear to confuse the purpose of 30 CFR 732.17(f), which allows OSM to require changes in State programs, with the purpose of 30 CFR 732.17(h)(8), which allows a State, on its own initiative, once a proposed amendment is disapproved, to submit a revised version to OSM for reconsideration. The 30 day time limit applies to voluntary submissions of revised versions of disapproved amendments under 30 CFR 732.17(h)(8). The 60 day time limit applies to mandatory submissions for changes to a State program under 30 CFR 732.17(f). Since Wyoming's February 28, 1994, submission was a response to an OSM required change to Wyoming's program, rather than a voluntary submission of a revised version of disapproved amendment, OSM applied the correct time limit in when it allowed 60 days for Wyoming to respond to the required amendment. For additional information on the purposes of 30 CFR 732.17(f) and 30 CFR 732.17(h)(8), please see the June 17, 1982, **Federal Register** (47 FR 26356, 26360–1) and the January 23, 1981, **Federal Register** (46 FR 7906).

The commenters also asserted that OSM has failed to enforce 30 CFR 732.17(f)(2) and that 30 CFR 733 proceedings (substitution Federal enforcement of a State program) should be instituted. The Federal regulations at 30 CFR 732.17(f)(2) require that if a State RA does not submit a proposed amendment or a description of an amendment along with a timetable for enactment within 60 days from receipt of notice by the Director, or does not comply with the submitted schedule, then the Director shall begin proceedings under 30 CFR part 733.

As discussed above, Wyoming's February 28, 1994, letter, which included a description of an amendment with a timetable for its enactment, satisfied the requirement at 30 CFR 732.17(f)(1), that a proposed amendment or description of amendment and timetable for enactment, be submitted within 60 days of notification of the required changes in the State program. Having met the deadline at 30 CFR 732.17(f)(1), it would be inappropriate for OSM to institute 30 CFR part 733 proceedings against Wyoming at this time.

In addition, as discussed in detail in the commenters' letter, Wyoming has gone through a negotiated rulemaking process once before which was submitted to OSM for review as a formal amendment. At the same time, legislative action created statutes that conflicted with the negotiated rules. Consequently, OSM did not approve the rules and the statutes and required the State to amend its program. It is apparent, based upon the history described by the commenters, that the State has been working on correcting this deficient portion of the program and that 30 CFR part 733 proceedings would not be appropriate while the State is working on correcting the deficiency.

Because of the 1994 legislative repeal of those portions of the conflicting statutes and results of the "negotiated rulemaking," it would appear that the State is in a position to submit an amendment that will correct this portion of its program. The proposed statute changes for the 1995 legislative session should resolve the most recently discovered statutory conflicts and thus allow completion of the formal rulemaking process. OSM believes that this is the appropriate process to assure that the deficiency identified in the required amendment is adequately remedied.

The commenters pointed out that specific portions of Wyoming's

timetable, as revised on September 1, 1994, are quite lengthy. The commenters assert that they are concerned with the 60 days the timetable allows for "minor changes to the proposed shrub density rule in response to the adopted legislation" from April through May 1995, as well as the 90 days the timetable allows, after the Environmental Quality Council (EQC) approval of the proposed rules, but before submission of the amendment package to OSM, from September through November 1995. The commenters also mentioned that Wyoming's program includes a provision allowing the EQC to meet in an emergency hearing, which would speed the rulemaking process, but that Wyoming has not pursued this option.

OSM believes the 60 days allotted for dealing with "minor changes" shows acceptable caution on the part of Wyoming. OSM understands that, if the 60 days is not needed, the state will press forward with its formal rulemaking process. Allowing 90 days to submit the negotiated rule to OSM after approval by the EQC reflects Wyoming's administrative processes and procedures. Rules must be filed with the Secretary of State within 60 days after approval by the EQC. The EQC hearings can be held at any time during the month. Therefore, Wyoming's planned September 1995 EQC hearing could take place at the beginning or end of that month. If it takes place at the end of the month, then the 60-day filing deadline may not occur until the end of November 1995. Wyoming is again using acceptable caution in establishing this time frame. Regarding Wyoming's ability to request an emergency EQC hearing, under State law, such a request can only be made in a genuine emergency situation. In other words, only an unplanned or unanticipated event justifies an emergency hearing of the EQC. The current rulemaking, while important, is neither unplanned nor unanticipated. In addition OSM understands that Wyoming is retaining the option to request an emergency EQC hearing if the need arises.

*Agency Comments*

The Bureau of Land Management responded by determining that the amendment as written will have no effect on BLM operations. (Administrative Record No. WY–26–6)

**V. Director's Decision**

Based on the above, the Director is approving Wyoming's February 28, 1994, proposed timetable for enactment of a required amendment, as revised by Wyoming's September 1, 1994, request for extension of that timetable. The timetable, as revised, will allow Wyoming to enact the required program amendments specified at 30 CFR 950.16 (bb) through (gg). The timetable, as revised, extends through November 30, 1995.

This final rule is being made effective immediately to expedite the State program amendment process and to encourage States to bring their programs into conformity with the Federal standards without undo delay. Consistency of State and Federal standards is required by SMCRA.

**VI. Procedural Determinations**

*Compliance With Executive Order 12866*

This final rule is exempted from review by the Office of Management and Budget under Executive Order 12866 (Regulatory Planning and Review).

*Compliance With Executive Order 12778*

The Department of the Interior has conducted the reviews required by section 2 of Executive Order 12778 (Civil Justice Reform) and has determined that this rule meets the applicable standards of subsection (a) and (b) of that section. However, these standards are not applicable to the actual language of State regulatory programs and program amendments since each such program is drafted and promulgated by a specific State, not by OSM. Under sections 503 and 505 of SMCRA (30 U.S.C. 1253 and 1255) and the Federal regulations at 30 CFR 730.11, 732.15, and 732.17(h)(10), decisions on proposed State regulatory programs and program amendments submitted by the States must be based solely on a determination of whether the submittal is consistent with SMCRA and its implementing Federal regulations and whether the requirements of 30 CFR Parts 730, 731, and 732 have been met.

*Compliance With the National Environmental Policy Act*

No environmental impact statement is required for this rule since section 702(d) of SMCRA (30 U.S.C. 1292(d)) provides that agency decisions on proposed State regulatory program provisions do not constitute major Federal actions within the meaning of section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332(2)(C)).

*Paperwork Reduction Act*

This rule does not contain information collection requirements that require approval by the Office of Management and Budget under the Paperwork Reduction Act (44 U.S.C. 3507 *et seq.*).

*Compliance With the Regulatory Flexibility Act*

The Department of the Interior has determined that this rule will not have a significant economic impact on a substantial number of small entities under the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*). The State submittal which is the subject of this rule is based upon counterpart Federal regulations for which an economic analysis was prepared and certification made that such regulations would not have a significant economic effect upon a substantial number of small entities. Hence, this rule will ensure that existing requirements previously promulgated by OSM will be implemented by the State. In making the determination as to whether this rule would have a significant economic impact, the Department relied upon the data and assumptions for the counterpart Federal regulations.

**List of Subjects in 30 CFR Part 950**

Intergovernmental relations, Surface Mining, Underground mining.

Dated: December 19, 1994.

**Charles E. Sandberg,**

*Acting Assistant Director, Western Support Center.*

For the reasons set out in the preamble, Title 30, Chapter VII, Subchapter T, the Code of Federal Regulations is amended as set forth below.

**PART 950—WYOMING**

1. The authority citation for Part 950 continues to read as follows:

**Authority:** 30 U.S.C. 1201 *et seq.*

2. In § 950.16, paragraph (hh) is added to read as follows:

**§ 950.16 Required program amendments.**

* * * * *

(hh) By letters dated February 28, 1994, and September 1, 1994, Wyoming submitted a description of required amendments, time table for enactment, and request for additional time to complete the rulemaking for paragraphs (aa) through (gg) of this section. The request provides that Wyoming will have through November 30, 1995, to submit those required program amendments.

[FR Doc. 94–31599 Filed 12–22–94; 8:45 am]

BILLING CODE 4310–05–M

DEPARTMENT OF TRANSPORTATION

Coast Guard

33 CFR Part 165

[CGD01–94–153]

RIN 2115–AA97

## Safety Zone; South Street Seaport, New Year's Eve Fireworks, East River, NY

AGENCY: Coast Guard, DOT.

ACTION: Temporary final rule.

SUMMARY: The Coast Guard is establishing a temporary safety zone for the South Street Seaport, New Year's Eve Fireworks display in the East River, New York, on December 31, 1994, to protect the boating public from the hazards associated with fireworks exploding in the area. This event, sponsored by South Street Seaport, Inc., will take place from 11:30 p.m. on December 31, 1994, to 12:45 a.m. on January 1, 1995, unless extended or terminated sooner by the Captain of the Port, New York. This regulation will temporarily close all waters of the East River south of the Brooklyn Bridge and north of a line drawn from Pier 9, Manhattan, to Pier 3, Brooklyn. This safety zone will preclude all vessels from transiting this portion of the East River.

EFFECTIVE DATES: This rule is effective from 11:30 p.m. on December 31, 1994, to 12:45 a.m. on January 1, 1995, unless extended or terminated sooner by the Captain of the Port, New York.

FOR FURTHER INFORMATION CONTACT: Lieutenant R. Trabocchi, Planning and Readiness Division Officer, Coast Guard Group New York (212) 668–7934.

SUPPLEMENTARY INFORMATION:

### Drafting Information

The drafters of this notice are LT R. Trabocchi, Project Manager, Captain of the Port, New York and LCDR J. D. Steib, Project Attorney, First Coast Guard District, Legal Office.

### Regulatory History

On November 8, 1994, the Coast Guard published a noticed of proposed rulemaking (NPRM) in the **Federal Register** (59 FR 55603) concerning this regulatory action. Interested persons were requested to submit comments on or before December 8, 1994. No comments were received. A public hearing was not requested and one was not held. The Captain of the Port, New York, is promulgating this temporary final rule as proposed. Good cause exists for making this rule effective less than 30 days after **Federal Register** publication. Due to the length of the comment period deemed necessary to provide the public with adequate notice, there is insufficient time to publish this rule 30 days before the event. Making this rule effective in less than 30 days after publication is in the public interest as any delay would effectively cause cancellation of the event.

### Background and Purpose

South Street Seaport, Inc., submitted an application to hold a fireworks program in the waters of the East River on December 31, 1994. Following the notice and comment period described above, the Captain of the Port, New York, now promulgates this temporary final rule as proposed and establishes a safety zone for the annual event known as the "South Street Seaport New Year's Eve Fireworks", in the waters of the East River.

### Regulatory Evaluation

This regulation is not a significant regulatory action under section 3(f) of Executive Order 12866 and does not require an assessment of potential costs and benefits under section 6(a)(3) of that order. It has been exempted from review by the Office of Management and Budget under that order. It is not significant under the regulatory policies and procedures of the Department of Transportation (DOT) (44 FR 11040; February 26, 1979). The Coast Guard expects the economic impact of this regulation to be so minimal that a full Regulatory Evaluation under paragraph 10(e) of the regulatory policies and procedures of DOT is unnecessary. This safety zone will close a portion of the East River to all vessel traffic between 11:30 p.m. on December 31, 1994, and 12:45 a.m. on January 1, 1995, unless extended or terminated sooner by the Captain of the Port, New York. Although this regulation will prevent traffic from transiting this area, the effect of this regulation will not be significant for several reasons. Due to the limited duration of the event; the minimal traffic expected due to the late hour of the event and winter season; the extensive advance advisories that will be made to the maritime community to allow for the scheduling of transits before and after the event; and that pleasure craft and some commercial vessels can take an alternate route via the Hudson and Harlem Rivers, the Coast Guard expects the economic impac of this regulation to be so minimal that a Regulatory Evaluation is unnecessary.

### Small Entities

Under the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), the Coast Guard must consider whether this regulation will have a significant economic impact on a substantial number of small entities. "Small entities" include independently owned and operated small businesses that are not dominant in their field and that otherwise qualify as "small business concerns" under section 3 of the Small Business Act (15 U.S.C. 632).

For reasons set forth in the above Regulatory Evaluation, the Coast Guard expects the impact of this regulation to be minimal. The Coast Guard certifies under 5 U.S.C. 605(b) that this regulation will not have significant economic impact on a substantial number of small entities.

### Collection of Information

This regulation contains no collection of information requirements under the Paperwork Reduction Act (44 U.S.C. 3501).

### Federalism

The Coast Guard has analyzed this action in accordance with the principles and criteria contained in Executive Order 12612 and has determined that this regulation does not raise sufficient federalism implications to warrant the preparation of a Federalism Assessment.

### Environment

The Coast Guard has considered the environmental impact of this regulation and concluded that under section 2.B.2.e. of Commandant Instruction M16475.1B, it is categorically excluded from further environmental documentation. A Categorical Exclusion Determination is included in the docket.

### List of Subjects in 33 CFR Part 165

Harbors, Marine safety, Navigation (water), Reporting and recordkeeping requirements, Security measures, Waterways.

### Final Regulations

For reasons set out in the preamble, the Coast Guard amends 33 CFR part 165 as follows:

## PART 165—[AMENDED]

1. The authority citation for part 165 continues to read as follows:

**Authority:** 33 U.S.C. 1231; 50 U.S.C. 191; 33 CFR 1.05–1(g), 6.04–1, 6.04–6, and 160.5; 49 CFR 1.46.

2. A temporary § 165.T01–153 is added to read as follows:

**§ 165.T01–153 Safety Zone; South Street Seaport, New Year's Eve Fireworks, East River, NY.**

(a) *Location.* All waters of the East River, New York, south of the Brooklyn Bridge and north of a line drawn from Pier 9, Manhattan to Pier 3, Brooklyn.

(b) *Effective period.* This section is effective from 11:30 p.m. on December 31, 1994, to 12:45 a.m. on January 1, 1995, unless extended or terminated sooner by the Coast Guard, Captain of the Port, New York.

(c) *Regulations.* (1) The general regulations contained in 33 CFR 165.23 apply.

(2) All persons and vessels shall comply with the instructions of the Coast Guard Captain of the Port or the designated on scene patrol personnel. U.S. Coast Guard patrol personnel include commissioned, warrant, and petty officers of the Coast Guard. Upon being hailed by a U.S. Coast Guard vessel via siren, radio, flashing light, or other means, the operator of a vessel shall proceed as directed.

Dated: December 15, 1994.

**T.H. Gilmour,**

*Captain, U.S. Coast Guard, Captain of the Port, New York.*

[FR Doc. 94–31628 Filed 12–22–94; 8:45 am]

BILLING CODE 4910–14–M

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**33 CFR Part 165**

**[CGD01–94–160]**

**RIN 2115–AA97**

## Safety Zone; First Night Martha's Vineyard Fireworks Display

**AGENCY:** Coast Guard, DOT.

**ACTION:** Temporary final rule.

**SUMMARY:** The Coast Guard is establishing a temporary safety zone in Vineyard Haven Harbor, Vineyard Haven, MA, on December 31, 1994, during the annual the First Night Martha's Vineyard fireworks display. The zone will be around a barge anchored just outside the Vineyard Haven jetty. This safety zone is necessary to protect pleasure craft and persons aboard these vessels from injury due to potential hazards associated with the fireworks.

**EFFECTIVE DATE:** This regulation is effective between the hours of 10 p.m. to 10:45 p.m. on December 31, 1994.

**FOR FURTHER INFORMATION CONTACT:** LT David Dolloff, Marine Safety Field Office Cape Cod, (508) 968–6556.

**SUPPLEMENTARY INFORMATION:**

### Drafting Information

The principal persons involved in drafting this document are LT D. H. Dolloff, Project Manager, and LCDR F. J. Kenney, Project Counsel, First District Legal Office.

### Regulatory History

Pursuant to 5 U.S.C. 553, a notice of proposed rulemaking was not published for this regulation and good cause exists for making it effective in less than 30 days after **Federal Register** publication. Because of the late date the Coast Guard received the application, there was not sufficient time to publish proposed rules in advance of the event. First Night Martha's Vineyard is a popular local event centered around the New Years national holiday. Delaying the event would result in its cancellation.

### Background and Purpose

On December 31, 1994, First Night Martha's Vineyard will sponsor a fireworks display between the hours of 10 p.m. and 10:45 p.m. in celebration of New Years Eve. A safety zone is needed to prohibit spectator vessels from transiting or anchoring in the area of the barge over which the fireworks will be launched. The safety zone will cover an area within a 400 yard radius of the anchored fireworks barge which will be in position 41°27'36" North 70°35'48" West (approximately 300 yards north of the Vineyard Haven jetty) between the hours of 10 p.m. to 10:45 p.m. on December 31, 1994.

### Regulatory Evaluation

This final rule is not a significant regulatory action under section 3(f) of Executive Order 12866 and does not require an assessment of potential costs and benefits under section 6(a)(3) of that order. It has been exempted from review by the Office of Management and Budget under that order. It is not significant under the regulatory policies and procedures of the Department of Transportation (DOT) (44 FR 11040; February 26, 1979). The Coast Guard expects the economic impact of this proposal to be so minimal that a full Regulatory Evaluation under paragraph 10e of the regulatory policies of DOT is unnecessary. These regulations will be in effect for only a short period. The entities most likely to be affected are pleasure craft wishing to view the fireworks. These vessels will still be able to view the fireworks but will be required to do so at a distance of more than 400 yards from the anchored barge, which will not cause them undue hardship. The effect on commercial traffic is negligible. There is a minimal amount of commercial traffic that transmits the area. Advisories will be made to allow any such vessels to adjust their schedules.

### Small Entities

Under the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), the Coast Guard must consider whether these regulations will have a significant economic impact on a substantial number of small entities. "Small entities" include independently owned and operated small businesses that are not dominant in their field and that otherwise qualify as "small business concerns" under section 3 of the Small Business Act (15 U.S.C. 632).

For the reasons outlined in the Regulatory Evaluation, the Coast Guard expects the impact to be minimal on all entities. Therefore, the Coast Guard certifies under 5 U.S.C. 605(b) that this final rule, if adopted, will not have a significant economic impact on a substantial number of small entities.

### Collection of Information

This final rule contains no collection of information requirements under the Paperwork Reduction Act (44 U.S.C. 3501).

### Federalism

The Coast Guard has analyzed this action in accordance with the principles and criteria contained in Executive Order 12612 and has determined that this proposal does not have sufficient federalism implications to warrant the preparation of a Federalism Assessment.

### Environment

The environmental impact of this rule has been evaluated using the Coast Guard's procedures for implementing the National Environmental Policy Act (Commandant Instruction M16474.1B). Under Section 2.B.2.(e) of these procedures, it is concluded that this action is categorically excluded from further environmental documentation. A Categorical Exclusion Determination will be made available in the docket.

### List of Subjects in 33 CFR Part 165

Harbors, Marine safety, Navigation (water), Reporting and recordkeeping requirements, Security measures, Waterways.

### Final Regulation

For the reasons set out in the preamble, the Coast Guard amends 33 CFR part 165 as follows:

## PART 165—[AMENDED]

1. The authority citation for part 165 continues to read as follows:

**Authority:** 33 U.S.C. 1231; 50 U.S.C. 191; 33 CFR 1.05–1(g), 6.04–1, 6.04–6 and 160.5; 49 CFR 1.46.

2. A temporary § 165.T01–160 is added to read as follows:

**§ 165.T01–160 Safety Zone: First Night Vineyard Haven Fireworks Display.**

(a) *Location.* The following area is a safety zone: All waters within a 400 yard radius of the anchored fireworks barge which will be in approximate position 41° 27′ 36″ North 70° 35′ 48″ West (approximately 300 yards north of the Vineyard Haven jetty).

(b) *Effective date.* This section becomes effective at 10 p.m. on December 31, 1994. It terminates at 10:45 p.m. on December 31, 1994, unless terminated sooner by the Captain of the Port.

(c) *Regulations.* The general regulations governing safety zones contained in 33 CFR 165.23 apply.

Dated: December 13, 1994.

**P.A. Turlo,**

*Captain, U.S. Coast Guard, Captain of the Port, Providence, RI.*

[FR Doc. 94–31627 Filed 12–22–94; 8:45 am]

BILLING CODE 4910–14–M

## ENVIRONMENTAL PROTECTION AGENCY

### 40 CFR Part 271

[FRL–5127–6]

### Louisiana: Final Authorization of State Hazardous Waste Management Program Revisions

**AGENCY:** Environmental Protection Agency.

**ACTION:** Immediate final rule.

**SUMMARY:** The State of Louisiana has applied for Final Authorization for revisions to its hazardous waste program under the Resource Conservation and Recovery Act. The Environmental Protection Agency (EPA) reviewed Louisiana's application and decided that its hazardous waste program revision satisfies all of the requirements necessary to qualify for Final Authorization. Unless adverse written comments are received during the review and comment period provided for public participation in this process, EPA intends to approve Louisiana's hazardous waste program revision subject to the authority retained by EPA in accordance with the Hazardous and Solid Waste Amendments of 1984. Louisiana's application for the program revision is available for public review and comment.

**DATES:** This Final Authorization for Louisiana shall be effective March 8, 1995, unless EPA publishes a prior **Federal Register** (*FR*) action withdrawing this Immediate Final Rule. All comments on Louisiana's program revision application must be received by the close of business February 6, 1995.

**ADDRESSES:** Copies of the Louisiana program revision application and the materials which EPA used in evaluating the revision are available for inspection and copying from 8:30 a.m. to 4 p.m. Monday through Friday at the following addresses: Louisiana Department of Environmental Quality, H. B. Garlock Building, 7290 Bluebonnet, Baton Rouge, Louisiana 70810, phone (504) 765–0617 and EPA, Region 6 Library, 12th Floor, First Interstate Bank Tower at Fountain Place, 1445 Ross Avenue, Dallas, Texas 75202, phone (214) 665–6444. Written comments, referring to Docket Number LA–95–2, should be sent to Alima Patterson, Authorization Coordinator, Grants and Authorization Section (6H–HS), RCRA Programs Branch, U.S. EPA Region 6, First Interstate Bank Tower at Fountain Place, 1445 Ross Avenue, Dallas, Texas 75202, (214) 665–8533.

**FOR FURTHER INFORMATION CONTACT:** Alima Patterson, Authorization Coordinator, Grants and Authorization Section (6H–HS), RCRA Programs Branch, U.S. EPA Region 6, First Interstate Bank Tower at Fountain Place, 1445 Ross Avenue, Dallas, Texas 75202, (214) 665–8533.

**SUPPLEMENTARY INFORMATION:**

#### A. Background

States with final authorization under section 3006(b) of the Resource Conservation and Recovery Act ("RCRA or the Act"), 42 U.S.C. 6926(b), have a continuing obligation to maintain a hazardous waste program that is equivalent to, consistent with, and no less stringent than the Federal hazardous waste program. Revisions to State hazardous waste programs are necessary when Federal or State statutory or regulatory authority is modified or when certain other changes occur. Most commonly, State program revisions are necessitated by changes to EPA's regulations in 40 CFR 124, 260–268, and 270.

#### B. Louisiana

Louisiana initially received Final Authorization, effective February 7, 1985 (see 50 FR 3348), to implement its base hazardous waste management program. Louisiana received authorization for revisions to its program effective January 29, 1990 (see 54 FR 48889), and October 25, 1991 (see 56 FR 41958), Corrections at (56 FR 51762) and effective January 23, 1995 (see 59 FR 55368–55371). On December 7, 1994, Louisiana submitted a final complete program revision application for additional program approvals. Today, Louisiana is seeking approval of its program revision in accordance with 40 CFR 271.21(b)(3).

In 1983, the Louisiana Legislature adopted Act 97, which amended and reenacted Louisiana Revised Statutes 30:1051 et seq., the Environmental Affairs Act. This Act created the Louisiana Department of Environmental Quality (LDEQ), which has lead agency jurisdictional authority for administering the RCRA Subtitle C program in the State.

EPA reviewed LDEQ's application, and made an immediate final decision that LDEQ's hazardous waste program revision satisfies all of the requirements necessary to qualify for Final Authorization. Consequently, EPA intends to grant Final Authorization for the additional program modifications to the State. The public may submit written comments on EPA's final decision until February 6, 1995. Copies of LDEQ's application for program revision are available for inspection and copying at the locations indicated in the **ADDRESSES** section of this notice.

Approval of LDEQ's program revision shall become effective 75 days from the date this notice is published, unless an adverse written comment pertaining to the State's revision discussed in this notice is received by the end of the comment period. If an adverse written comment is received, EPA will publish either (1) a withdrawal of the immediate final decision or (2) a notice containing a response to the comment that either affirms that the immediate final decision takes effect or reverses the decision.

Louisiana's program revision application includes State regulatory changes that are at least equivalent to the rules promulgated in the Federal RCRA implementing regulations in 40 CFR Parts 124, 260–262, 264, 265, 266 and 270, that were published in the FR through June 30, 1988. This proposed approval includes the provisions that are listed in the chart below. This chart also lists the State analogs that are being recognized as equivalent to the appropriate Federal requirements.