[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-109101-98]

Special Rules Regarding Optional Forms of Benefit Under Qualified Retirement Plans

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations that would permit qualified defined contribution plans to be amended to eliminate some alternative forms in which an account balance can be paid under certain circumstances, and would permit certain transfers between defined contribution plans that are not permitted under regulations now in effect. These proposed regulations affect qualified retirement plan sponsors, administrators, and participants. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by June 27, 2000. Requests to speak and outlines of oral comments to be discussed at the public hearing scheduled for June 27, 2000, at 10 a.m., must be received by June 6, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-109101-98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-109101-98), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option of the IRS Home Page, or by submitting comments directly to the IRS Internet site at: http://www.irs.gov/tax_regs/reglist.html. The public hearing will be held in room 6718, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Linda S. F. Marshall, 202-622-6030; concerning submissions and the hearing, and/or to be placed on the building access list to attend the hearing, LaNita VanDyke, 202-622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to 26 CFR part 1 under section 411(d)(6) of the Internal Revenue Code of 1986 (Code).

Section 411(d)(6) generally provides that a plan will not be treated as satisfying the requirements of section 411 if the accrued benefit of a participant is decreased by a plan amendment. Section 411(d)(6)(B), which was added by the Retirement Equity Act of 1984 (REA), Public Law 98-397 (98 Stat. 1426), provides that a plan amendment that eliminates an optional form of benefit is treated as reducing accrued benefits to the extent that the amendment applies to benefits accrued as of the later of the adoption date or the effective date of the amendment. However, section 411(d)(6)(B) authorizes the Secretary of the Treasury to provide exceptions to this requirement. This authority does not extend to a plan amendment that would have the effect of eliminating or reducing an early retirement benefit or a retirement-type subsidy.

Final regulations regarding section 411(d)(6)(B) were published in the **Federal Register** on July 8, 1988. Those final regulations, and subsequent amendments to the regulations, define the optional forms of benefit that are protected under section 411(d)(6)(B) and provide for certain exceptions to the general rule of section 411(d)(6)(B). In general, existing regulatory exceptions to the application of section 411(d)(6)(B) to optional forms of benefit have been developed to address certain specific practical problems. For example, §1.411(d)-4, Q&A-3(b) permits a transfer between plans of a participant's entire nonforfeitable benefit to be made at the election of the participant, without a requirement that the transferee plan preserve all section 411(d)(6) protected benefits, but only if the participant is eligible to receive an immediate distribution and certain other conditions are satisfied. In addition, some regulatory exceptions to the application of section 411(d)(6)(B) to optional forms of benefit address plan amendments that are related to statutory changes. See Q&A-2(b) and Q&A-10 of §1.411(d)-4.

The IRS and Treasury recognize that the accumulation of a variety of payment choices in a plan may increase the cost and complexity of plan operations. For example, an employer that initially adopted a plan for which the plan document was prepared by a prototype sponsor may now be using a different prototype plan that offers a different array of distribution forms. The requirement to preserve virtually all preexisting optional forms for benefits accrued up to the date of change in the prototype plan may present significant practical problems in certain cases.

Similar issues arise where employers merge with or acquire other businesses. These employers often face issues of whether to maintain separate plans, terminate one or more of the plans, or merge the plans. If the employer chooses to merge the plans, the resulting plan may accumulate a wide variety of optional forms, some of which may differ in insignificant ways or may entail special administrative costs. Because the existing elective transfer rule of §1.411(d)-4, Q&A-3(b) applies only to situations in which a participant's benefits have become distributable, its applicability is limited.

In recent years, it has become easier for individuals to replicate the various payment choices available from qualified plans through other means. The Unemployment Compensation Amendments of 1992, Public Law 102-318 (106 Stat. 290), substantially expanded participants' ability to transfer distributions from qualified plans to individual retirement arrangements (IRAs) on a tax-deferred basis. Individuals who receive single-sum distributions from qualified plans frequently roll those distributions over directly to IRAs, under which distributions can be made in a wide variety of payment forms. There are also indications that the vast majority of participants in defined contribution plans who are given a choice of distribution forms that includes a single-sum distribution elect the single-sum distribution.

The IRS and Treasury have been weighing these considerations as they apply to various circumstances and various benefit forms. As a result, the IRS and Treasury have been considering the appropriateness of exercising the regulatory authority under section 411(d)(6)(B) to provide additional exceptions under that provision, in order to allow greater flexibility for sponsors to modify alternative forms of payment and simplify plan provisions and plan administration.

Notice 98-29 (1998-1 C.B. 1163) requested public comment on several ways of providing regulatory relief from the requirements of section 411(d)(6)(B) for defined contribution plans. Most of the public comments received in response to Notice 98-29 indicate that, particularly for defined contribution plans, the section 411(d)(6)(B) requirement that a plan continue to offer all existing payment options often imposes significant administrative burdens that are disproportionate to any corresponding benefit to participants. Accordingly, after considering the comments received in response to Notice 98-29, the IRS and Treasury are issuing these proposed regulations, which would provide relief from the requirements of section 411(d)(6)(B) in a wide range of circumstances.

As anticipated in Notice 98-29, the primary focus of these regulations is on defined contribution plans, and the provisions of these regulations relating to elimination of alternative forms of payment are limited to defined contribution plans. Defined benefit plans have special characteristics, including benefit payment calculation specifications, early retirement benefits, and other retirement-type subsidies (for which section 411(d)(6)(B) does not authorize the issuance of regulatory relief). Features such as these are not characteristic of defined contribution plans and provide important protections to participants. While limited comments relating to defined benefit plans were received in response to Notice 98-29, the IRS and Treasury remain open to further comment in this area. As discussed below, the provisions of these proposed regulations relating to elimination of in-kind distributions extend to both defined contribution plans and defined benefit plans, and the provisions of these proposed regulations relating to transfers between plans apply to defined contribution plans and, to some extent, to defined benefit plans.

These proposed regulations would not affect other requirements of the Code. For example, a money purchase pension plan (or a plan otherwise described in section 401(a)(11)(B)) generally must satisfy certain requirements relating to qualified joint and survivor annuities and qualified preretirement survivor annuities. Similarly, these proposed regulations would not affect the requirements of section 401(a)(31) relating to direct rollovers.

Explanation of Provisions

A. Permitted Amendments to Alternative Forms of Payment Under a Defined Contribution Plan

The proposed regulations would simplify plan administration and allow greater flexibility by significantly expanding the permitted changes that may be made to alternative forms of payment under a defined contribution plan. Instead of requiring defined contribution plans to continue to maintain nearly all existing alternative forms of payment with only limited exceptions, these proposed regulations would permit defined contribution plans to be amended to eliminate nearly all existing forms of payment if certain specified forms of payment are available. Under the proposed regulations, a defined contribution plan would not violate the requirements of section 411(d)(6) merely because the plan was amended to eliminate or restrict the ability of a participant to receive payment of the participant's accrued benefit under a particular optional form of benefit if, after the plan amendment became effective with respect to the participant, the distribution choices available to the participant included both payment of the accrued benefit in a single-sum distribution form and payment of the accrued benefit in an extended distribution form, each of which is otherwise identical to the eliminated or restricted optional form of benefit.

Under the proposed regulations, a distribution form is an otherwise identical distribution form with respect to an optional form of benefit that is eliminated or restricted only if the distribution form is identical in all respects to the eliminated or restricted optional form of benefit except with respect to the timing of payments after commencement. For example, a single-sum distribution form is not an otherwise identical distribution form with respect to a specified installment form of benefit if the single-sum distribution form is not available for distribution on any date on which the installment form would have been available for commencement, is not available in the same medium of distribution as the installment form, does not apply to the benefit to which the installment form applied, imposes any condition of eligibility that did not apply to the installment form, or lacks any related election rights that were available with respect to the installment form. However, a distribution form does not fail to be identical just because it provides greater rights to the participant. Further, an otherwise identical distribution form need not retain rights or features of the optional form of benefit that is eliminated or restricted to the extent that those rights or features are not otherwise protected under section 411(d)(6). Moreover, in the case of an optional form of benefit that is in the form of an annuity and that provides for distribution of an annuity contract, a distribution form that is not in the form of an annuity would not fail to be an otherwise identical distribution form with respect to that optional form of benefit merely because the non-annuity distribution form does not provide for distribution of an annuity contract.

The requirement under the proposed regulations that an extended distribution form be retained would be satisfied if the plan provided either (1) a life annuity or (2) periodic payments over the participant's life expectancy (or, at the election of the participant, over the joint life expectancy of the participant and the participant's spouse). Thus, a defined contribution plan would not violate section 411(d)(6) merely because of a plan amendment that replaced an optional form of benefit payable under the plan with either of these two extended distribution forms, together with a single-sum distribution form, provided that the single-sum distribution form and the extended distribution form are each otherwise identical to the replaced optional form of benefit. A plan providing for periodic payments over life expectancy could provide for the life expectancy to be fixed when payments begin or, alternatively, could provide for the life expectancy to be redetermined annually as described in section 401(a)(9)(D).

As noted above, the proposed regulations would not affect the survivor annuity requirements of sections 401(a)(11) and 417. Thus, for example, as required under sections 401(a)(11) and 417, any profit-sharing plan that provides for payment in the form of a life annuity (whether or not the life annuity was added to the plan in lieu of some other optional form) would also be required to offer payment in the form of a qualified joint and survivor annuity.

A third extended distribution form would generally be permitted under the proposed regulations for a plan amendment that did not eliminate any optional form of benefit that is an extended distribution form described above. For such an amendment, the requirement to provide an extended distribution form would be satisfied if the plan offered a distribution in the form of substantially equal periodic payments made (not less frequently than annually) over a period at least as long as the longest period over which the participant is entitled to receive a distribution under the plan before the plan amendment under any of the optional forms of benefit that are eliminated by the plan amendment. Thus, for example, a defined contribution plan that offers distributions in the form of a single-sum distribution, 5-year installment payments, 10-year installment payments, 15-year installment payments, and 20-year installment payments could be amended to offer only a single-sum distribution and 20-year installment payments, each of which is otherwise identical to the formerly available 5-year, 10-year, and 15-year distribution forms.

The provisions of the proposed regulations permitting payment forms to be eliminated if the defined contribution plan retains a single-sum distribution form and an extended distribution form are similar to one of the proposals outlined in Notice 98-29. In response to Notice 98-29, commentators generally stated that implementing this relief would be very helpful for plan sponsors, but there was also substantial comment urging further relief, so that a defined contribution plan with a single-sum distribution option would not also be required to continue to offer an extended distribution form. These commentators took the position that, in light of a participant's ability to roll over distributions to IRAs, which may offer multiple payment forms, there is only a marginal advantage to the participant in requiring the retention of an option to receive extended payments from a qualified defined contribution plan.

Some of these comments described plans that have been preserving a variety of payment options because the regulations require it, even though certain of the options have not been selected by a single participant for years. Commentators asserted that ultimately, employee demand would tend to shape the array of payment options offered by plan sponsors, and that plan sponsors generally would feel more free to offer or "test market" various payment form alternatives to participants if the sponsors were not legally prohibited from ever removing any option, once offered, even when participants in the plan have evidenced little or no interest in the option. Commentators observed that participants would in all events continue to have the option to leave their account balance in the plan (if above the $5,000 cashout threshold) until they were ready to begin receiving distributions. It was argued that the vast majority of participants are not ready to begin drawing lifetime retirement benefits at the time their employment with a particular plan sponsor terminates, and that, accordingly, a participant's rollover to a single IRA of the participant's benefits from a series of employer-sponsored plans over the course of the participant's working life is an effective and common means of achieving portability, consolidation, and preservation of retirement savings.

Commentators also asserted that the protections of section 411(d)(6)(B) may have adversely affected participants involved in corporate sale transactions. Specifically, some sellers and buyers that might otherwise have merged their plans, or transferred benefits under the seller's plan to the buyer's plan, instead have terminated the seller's plan or made distributions in order to avoid being required to preserve all of the distribution forms in the seller's plan.

Although the comments received in response to Notice 98-29 made a strong case that only a single sum distribution should be required to be retained, these proposed regulations reflect the view that the advantages to participants from retaining an extended distribution form may be worth the plan administration costs of retaining this additional option. These advantages include the benefits that participants, especially less sophisticated participants, can derive from employer involvement, which is subject to the fiduciary standards, in selecting and monitoring investment options under the plan after retirement distributions have begun. The IRS and Treasury are open to further comments on whether or not an extended distribution form should be required to be preserved, including comments that identify circumstances in which it may be acceptable for a plan not to preserve an extended distribution form. In particular, comments are requested on whether the final regulations should provide any of the following further relief:

- Should an extended distribution form be required to be retained only for participants who have reached a specified age, such as age 55, age 62, or normal retirement age, at the time of the distribution?

- Should there be an exception from this requirement for small businesses (e.g., employers with fewer than 100 employees or fewer than 25 employees)?
- Should a plan be treated as satisfying the requirement that it retain an extended distribution form if the plan allows a participant to elect to receive distribution by transfer of his or her vested account to a defined benefit plan for distribution in an extended distribution form?
- Should a plan be treated as satisfying the requirement that it retain an extended distribution form if the plan offers installment payments over a fixed period, such as 20 years?
- Should there be an exception from the requirement that an extended distribution form be retained if a plan with an extended distribution form is merged into another plan that does not offer an extended distribution form (for example, if the plan without the extended distribution form has a larger number of participants) in connection with an asset or stock acquisition, merger, or similar transaction involving a change in employer of the employees of a trade or business?
- If extended distribution forms are permitted to be eliminated, should there be additional protections, such as requiring that the amendment not go into effect for a specified period (such as two, four, or five years) or that the amendment not apply to participants who have reached a specified age (such as age 55, age 62, or normal retirement age) at the time of the amendment, or both?

Approaches such as these may be considered either independently of each other, as a series of coordinated alternatives, or in combination (such as permitting small businesses to limit the availability of extended distribution forms to participants who receive distributions after attaining a specified age, or such as permitting plan amendments that make extended distribution forms available only to participants who reach a specified age before a specified date, such as five years after the amendment). Commentators are requested to identify the burdens in plan administration that may be reduced by any of these approaches and the extent to which the approaches involve elimination of distribution alternatives that may be important to a participant.

B. Voluntary Direct Transfers Between Plans

The proposed regulations would make a number of changes in the existing regulations relating to elective transfers between qualified plans. Under certain circumstances, the existing regulations permit elimination of optional forms of benefit in connection with plan transfers with a participant's consent. The proposed regulations would significantly liberalize the application of these elective transfer provisions.

The existing regulations do not permit an elective transfer from one qualified plan to another unless the participant's benefit under the transferring plan is immediately distributable. This condition has precluded use of the elective transfer provision in the existing regulations in connection with merger and acquisition transactions involving plans with a cash or deferred arrangement under section 401(k) in cases in which benefits under the cash or deferred arrangement are not distributable because section 401(k)(10) is not applicable. Many commentators have stated that permitting elective transfers from the former employer's section 401(k) plan to the new employer's section 401(k) plan under these circumstances would allow employers to permit employees to keep their old retirement benefits in a qualified plan together with their newly earned retirement benefits, particularly in cases where the new employer chooses not to maintain the former employer's plan.

The proposed regulations would grant broad section 411(d)(6) relief for many types of elective transfers of a participant's entire benefit, without regard to whether the participant's benefit is immediately distributable. The elective transfer provision would be available for transfers made in connection with certain corporate transactions (such as a merger or acquisition), or in connection with the transfer of a participant to a different job (for example, to a different subsidiary or division of the employer) that is not covered by the transferor plan, even if the event is not one that allows a distribution. Insofar as the immediately distributable requirement of the existing regulations would be eliminated, the proposed regulations would permit an elective transfer even if the participant's benefit is not fully vested, provided that the requirements of section 411(a)(10) are satisfied. The proposed regulations would not restrict the permissible types of elective transfers to transfers between plans of the same employer. Accordingly, elective transfers could be made to plans that are within the employer's controlled group or to plans that are outside the employer's controlled group.

The proposed regulations would provide section 411(d)(6) relief for elective transfers involving corporate transactions or employee job transfers generally where the defined contribution plans are of the same type (e.g., from a qualified cash or deferred arrangement under section 401(k) to another qualified cash or deferred arrangement). The restrictions on the types of plans between which transfers would be permitted would ensure that amounts transferred to the receiving plan will be subject to similar legal restrictions with respect to in-service distributions. See Rev. Rul. 94-76 (1994-2 C.B. 46). In the case of transfers from plans that are subject to the survivor annuity requirements under sections 401(a)(11) and 417, those survivor annuity requirements would apply to the receiving plan with respect to the transferred amount in accordance with the transferee plan rules of section 401(a)(11)(B)(iii)(III).

The existing regulations relating to elective transfers were issued in 1988. Since then, section 401(a)(31) has been enacted. Under section 401(a)(31), any eligible rollover distribution may be directly rolled over to an IRA or to another eligible retirement plan. The section 411(d)(6) requirements do not apply to amounts that have been distributed, such as distributions that are directly rolled over to another plan under section 401(a)(31). Accordingly, the elective transfer rules of the existing regulations have largely been duplicated by the enactment of section 401(a)(31) because the same result generally is available through a direct rollover. The proposed regulations would eliminate this duplication by replacing the elective transfer rules of the existing regulations that apply to immediately distributable amounts, except for certain transfers of amounts that are not eligible rollover distributions (such as amounts attributable to after-tax employee contributions). Specifically, an elective transfer of an immediately distributable amount would be permitted to the extent the amount is not an eligible rollover distribution, if the participant's entire nonforfeitable accrued benefit is transferred by means of a combination of a section 401(a)(31) transfer and the elective transfer. This rule would apply to transfers between defined benefit plans, as well as transfers between defined contribution plans. Comments are requested regarding whether there are other situations (where direct rollovers are unavailable) to which the elective transfer approach should apply.

C. Rules Regarding In-Kind Distributions

The proposed regulations clarify and modify the rules regarding the application of the protections of section 411(d)(6)(B) to a right to receive benefit distributions in kind with respect to defined contribution plans and defined benefit plans. Provisions for distribution in kind are sometimes found in plans invested in annuity contracts or in marketable mutual funds. The right to a particular form of investment is not a protected optional form of benefit. However, the investments made by a plan generally are subject to fiduciary requirements, including the prudence requirement of section 404(a)(1)(B) of the Employee Retirement Income Security Act of 1974, Public Law 93-406 (88 Stat. 829). The existing regulations state that the right to a medium of distribution, such as cash or in-kind payments, is an optional form of benefit to which section 411(d)(6)(B) applies.

Under the proposed regulations, if a defined benefit plan includes an optional form of benefit under which benefits are distributed in the medium of an annuity contract, that optional form of benefit could be modified by substituting cash for the annuity contract. Thus, a defined benefit plan that provides for distribution of an annuity contract could be amended to substitute cash payments from the plan that are identical in all respects protected by section 411(d)(6) to the payments available from the annuity contract except with respect to the source of the payments. Comments are requested regarding whether any additional section 411(d)(6)(B) relief for non-cash distributions is appropriate for defined benefit plans.

The proposed regulations would permit a defined contribution plan to be amended to replace the ability to receive a distribution in the form of marketable securities (other than employer securities) with the ability to receive a distribution in the form of cash. The right to distributions from a defined contribution plan in the form of cash, employer securities or other property that is not marketable securities would generally be protected. However, the proposed regulations would also permit a defined contribution plan that gives a participant the right to an in-kind distribution (including employer securities and property that is not marketable securities) to be amended to limit the types of property in which distributions could be made to the participant to specific types of property in which the participant's account is invested at the time of the amendment (and with respect to which the participant had the right to receive an in-kind distribution before the plan amendment). In addition, the proposed regulations would permit a defined contribution plan giving a participant the right to a distribution in a type of property to be amended to specify that the participant is permitted to receive a distribution in that type of property only to the extent that the plan assets held in the participant's account at the time of the distribution include that type of property. These provisions of the proposed regulations would not permit a plan to be amended in a way that would affect protected features of optional forms of benefit other than the medium of distribution. Thus, for example, a plan could not be amended to eliminate a participant's right to payments over a period of years, regardless of the plan's current investments, except as permitted under other provisions of the current or proposed regulations (such as the provisions described above relating to permitted plan amendments affecting alternative forms of payment under defined contribution plans).

Comments are requested on whether section 411(d)(6) protection for in-kind distributions of employer securities and property that is not marketable securities from defined contribution plans should be preserved or eliminated. Commentators are requested to address the extent to which these may be important rights for participants. For example, in a defined contribution plan that does not give participants the right to payment in kind, it is possible that a distribution made in cash for a particular asset may be in an amount that is less than the value that the participant assigns to the asset. Commentators are further requested to address the potential administrative burden if, as proposed, plans are prohibited from eliminating these media of distribution. Comments are also requested on whether section 411(d)(6)(B) protection should be retained for any form of in-kind distribution from a defined contribution plan other than employer securities and property that is not marketable securities.

Proposed Effective Date

The proposed regulations are proposed to be effective upon publication of final regulations in the **Federal Register** and cannot be relied upon before finalization.

Special Analyses

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

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. In addition to the other requests for comments set forth in this document, the IRS and Treasury also request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for June 27, 2000, at 10 a.m., in room 6718, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC. Due to building security procedures, visitors must enter at the 10th street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who wish to present oral comments at the hearing must submit written comments by June 6, 2000, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by June 6, 2000.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Linda S. F. Marshall of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

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

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

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

Par. 2. Section 1.411(d)-4 is amended as follows:

1. In Q&A-1, paragraph (b)(1), the last sentence is amended by removing the language “§1.401(a)(4)-4(d)” and adding “§1.401(a)(4)-4(e)(1)” in its place.

2. Q&A-2 is amended by:

a. Revising paragraph (b)(2)(iii).

b. Adding paragraph (e).

3. Q&A-3 is amended by:

a. Revising paragraph (a)(3).

b. Adding paragraph (a)(4).

c. Revising paragraphs (b), (c), and (d).

d. Adding paragraph (e).

The additions and revisions read as follows:

<u>§1.411(d)-4 Section 411(d)(6) protected benefits</u>.

* * * * *

A-2: * * *

(b) * * *

(2) * * *

(iii) <u>In-kind distributions</u>–(A) <u>Distributions of annuity contracts payable under defined benefit plans</u>. If a defined benefit plan includes an optional form of benefit under which benefits are distributed in the medium of an annuity contract, that optional form of benefit may be modified by substituting cash for the annuity contract.

(B) In-kind distributions payable under defined contribution plans in the form of marketable securities other than employer securities. If a defined contribution plan includes an optional form of benefit under which benefits are distributed in the form of marketable securities, other than securities of the employer, that optional form of benefit may be modified by substituting cash for the marketable securities. For purposes of this paragraph (b)(2)(iii), the term marketable securities means marketable securities as defined in section 731(c)(2), and the term securities of the employer means securities of the employer as defined in section 402(e)(4)(E)(ii).

(C) Amendments to defined contribution plans to specify medium of distribution. If a defined contribution plan includes an optional form of benefit under which benefits are distributable to a participant in a medium other than cash, the plan may be amended to limit the types of property in which distributions may be made to the participant to the types of property specified in the amendment. For this purpose, the types of property specified in the amendment must include all types of property (other than types of property for which the plan may be amended to substitute cash under paragraph (b)(2)(iii)(B) of this Q&A-2) that are held in the participant's account on the effective date of the amendment and in which the participant would be able to receive a distribution immediately before the effective date of the amendment. In addition, a plan amendment may provide that the participant's right to receive a distribution in the form of specified types of property is limited to the property held in the participant's account at the time of distribution that consists of property of those specified types.

(D) In-kind distributions after plan termination. If a plan includes an optional form of benefit under which benefits are distributed in specified property, that optional form of benefit may be modified for distributions after plan termination by substituting cash for the specified property to the extent that, on plan termination, an employee has the opportunity to receive the optional form of benefit in the form of the specified property. This exception is not available, however, if the employer that maintains the terminating plan also maintains another plan that provides an optional form of benefit under which benefits are distributed in the specified property.

(E) Examples. The following examples illustrate the application of this paragraph (b)(2)(iii):

Example 1. (i) An employer maintains a profit-sharing plan under which participants may direct the investment of their accounts. One investment option available to participants is a fund invested in common stock of the employer. The plan provides that the participant has the right to a distribution in the form of cash upon termination of employment. In addition, the plan provides that, to the extent a participant's account is invested in the employer stock fund, the participant may receive an in-kind distribution of employer stock upon termination of employment. On September 1, 2000, the plan is amended, effective on January 1, 2001, to remove the fund invested in employer common stock as an investment option under the plan and to provide for the stock held in the fund to be sold. The amendment permits participants to elect how the sale proceeds are to be reallocated among the remaining investment options, and provides for amounts not so reallocated as of January 1, 2001, to be allocated to a specified investment option.

(ii) The plan does not fail to satisfy section 411(d)(6) solely on account of the plan amendment relating to the elimination of the employer stock investment option, which is not a section 411(d)(6) protected benefit. See paragraph (d)(7) of Q&A-1 of this section. Moreover, because the plan did not provide for distributions of employer securities except to the extent participants' accounts were invested in the employer stock fund, the plan is not required operationally to offer distributions of employer securities following the amendment. In addition, the plan would not fail to satisfy section 411(d)(6) on account of a further plan amendment, effective after the plan has ceased to provide for an employer stock fund investment option, to eliminate the right to a distribution in the form of employer stock. See paragraph (b)(2)(iii)(C) of this Q&A-2.

Example 2. (i) An employer maintains a profit-sharing plan under which a participant, upon termination of employment, may elect to receive benefits in a single-sum distribution either in cash or in kind. The plan's investments are limited to a fund invested in employer stock, a fund invested in XYZ mutual funds (which are marketable securities), and a fund invested in shares of PQR limited partnership (which are not marketable securities).

(ii) The following alternative plan amendments would not cause the plan to fail to satisfy section 411(d)(6):

(A) A plan amendment that limits non-cash distributions to a participant on termination of employment to a distribution of employer stock and shares of PQR limited partnership. See paragraph (b)(2)(iii)(B) of this Q&A-2.

(B) A plan amendment that limits non-cash distributions to a participant on termination of employment to a distribution of employer stock and shares of PQR limited partnership, and that also lists the participants that hold employer stock in their accounts as of the effective date of the amendment and provides that only those participants have the right to distributions in the form of employer stock, and lists the participants that hold shares of PQR limited partnership in their accounts as of the effective date of the amendment and provides that only those participants have the right to distributions in the form of shares of PQR limited partnership. See paragraphs (b)(2)(iii)(B) and (C) of this Q&A-2.

(C) A plan amendment that limits non-cash distributions to a participant on termination of employment to a distribution of employer stock and shares of PQR limited partnership to the extent that the participant's account is invested in those assets at the time of the distribution. See paragraphs (b)(2)(iii)(B) and (C) of this Q&A-2.

(D) A plan amendment that limits non-cash distributions to a participant on termination of employment to a distribution of employer stock and shares of PQR limited partnership, and that lists the participants that hold employer stock in their accounts as of the effective date of the amendment and provides that only those participants have the right to distributions in the form of employer stock, and lists the participants that hold shares of PQR limited partnership in their accounts as of the effective date of the amendment and provides that only those participants have the right to distributions in the form of shares of PQR limited partnership, and further provides that the distribution of that stock or those shares is available only to the extent that the participants' accounts are invested in those assets at the time of the distribution. See paragraphs (b)(2)(iii)(B) and (C) of this Q&A-2.

Example 3. (i) An employer maintains a stock bonus plan under which a participant, upon termination of employment, may elect to receive benefits in a single-sum distribution in employer stock. This is the only plan maintained by the employer under which distributions in employer stock are available. The employer decides to terminate the stock bonus plan.

(ii) If the plan makes available a single-sum distribution in employer stock on plan termination, the plan will not fail to satisfy section 411(d)(6) solely because the optional form of benefit providing a single-sum distribution in employer stock on termination of employment is modified to provide that such distribution is available only in cash. See paragraph (b)(2)(iii)(D) of this Q&A-2.

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(e) Permitted plan amendments affecting alternative forms of payment under defined contribution plans--(1) General rule. A defined contribution plan does not violate the requirements of section 411(d)(6) merely because the plan is amended to eliminate or restrict the ability of a participant to receive payment of accrued benefits under a particular optional form of benefit if, after the plan amendment is effective with respect to the participant, the alternative forms of payment available to the participant include payment in both a single-sum distribution form and an extended distribution form described in paragraph (e)(3) of this Q&A-2, each of which is an otherwise identical distribution form with respect to the optional form of benefit that is being eliminated or restricted.

(2) Otherwise identical distribution form. For purposes of this paragraph (e), a distribution form is an otherwise identical distribution form with respect to an optional

form of benefit that is eliminated or restricted pursuant to paragraph (e)(1) of this Q&A-2 only if the distribution form is identical in all respects to the eliminated or restricted optional form of benefit (or would be identical except that it provides greater rights to the participant) except with respect to the timing of payments after commencement. For example, a single-sum distribution form is not an otherwise identical distribution form with respect to a specified installment form of benefit if the single-sum distribution form is not available for distribution on the date on which the installment form would have been available for commencement, is not available in the same medium of distribution as the installment form, does not apply to the benefit (or any portion of the benefit) to which the installment form applied, imposes any condition of eligibility that did not apply to the installment form, or lacks any related election rights that were available with respect to the installment form. However, the single-sum distribution form would not fail to be an otherwise identical distribution form with respect to the installment form merely because the single-sum distribution form is available for distribution on a date on which the installment form would not have been available for commencement, is available in media of distribution that the installment form was not, applies (if the participant so chooses) to a larger portion of the benefit than the installment form, has fewer or less stringent conditions of eligibility than the installment form, or has election rights that the installment form lacked. In addition, an otherwise identical distribution form need not retain rights or features of the optional form of benefit that is eliminated or restricted to the extent that those rights or features are not otherwise protected under section 411(d)(6). Moreover, in the case of an optional form of benefit that is in the form of an annuity and that provides for distribution of an annuity contract, a distribution form that is not in the form of an annuity does not fail to be an otherwise identical distribution form with respect to that optional form of benefit merely because the non-annuity distribution form does not provide for distribution of an annuity contract.

(3) Extended distribution form–(i) In general. For purposes of this paragraph (e), a distribution form is an extended distribution form if it is--

(A) An annuity payable for the life of the participant;

(B) Substantially equal periodic payments made (not less frequently than annually), at the election of the participant, over either the life expectancy of the participant or the joint life expectancy of the participant and the participant's spouse (with or without redetermination of those life expectancies, as described in section 401(a)(9)(D)); or

(C) For a plan amendment that does not eliminate any optional form of benefit that is an extended distribution form described in paragraph (e)(3)(i)(A) or (B) of this Q&A-2, substantially equal periodic payments made (not less frequently than annually) over a period at least as long as the longest period over which the participant is entitled to receive a distribution under the plan before the plan amendment under any of the optional forms of benefit that are eliminated by the plan amendment.

(ii) Substantially equal periodic payments. For purposes of this paragraph (e)(3), the rules of section 402(c)(4)(A)(ii) and §1.402(c)-2, Q&A-5, apply in determining whether payments are substantially equal periodic payments (but without regard to the 10-year minimum period for payments and without regard to §1.402(c)-2, Q&A-5(b), regarding certain periodic payments that decrease upon a participant's attainment of eligibility for social security benefits).

(4) Examples. The following examples illustrate the application of this paragraph (e):

Example 1. (i) P is a participant in Plan M, a qualified profit-sharing plan that is invested in mutual funds. The distribution forms available to P under Plan M include a distribution of P's vested account balance under Plan M in the form of distribution of various annuity contract forms (including a single life annuity and a joint and survivor annuity). The annuity payments under the annuity contract forms begin as of the first day of the month following P's termination of employment (or as of the first day of any subsequent month, subject to the requirements of section 401(a)(9)). P has not previously elected payment of benefits in the form of a life annuity, and Plan M is not a direct or indirect transferee of any plan that is a defined benefit plan or a defined contribution plan that is subject to section 412. Plan M provides that distributions on the death of a participant are made in accordance with section 401(a)(11)(B)(iii)(I). Plan M is amended so that, after the amendment is effective, P is no longer entitled to any distribution in the form of the distribution of an annuity contract. However, after the amendment is effective, P is entitled to receive a single-sum cash distribution of P's vested account balance under Plan M payable as of the first day of the month following P's termination of employment (or as of the first day of any subsequent month, except as required by section 401(a)(9)). In addition, P is entitled to receive P's vested account balance under Plan M payable in substantially equal monthly payments made, at P's election, over either P's life expectancy or the joint life expectancies of P and P's spouse, beginning as of the first day of the month following P's termination of employment (or as of the first day of any subsequent month, except as required by section 401(a)(9)).

(ii) Plan M does not violate the requirements of section 411(d)(6) (or section 401(a)(11)) merely because the plan amendment has eliminated P's option to receive a distribution in any of the various annuity contract forms previously available.

Example 2. (i) P is a participant in Plan M, a qualified profit-sharing plan to which section 401(a)(11)(A) does not apply. Upon termination of employment, P is entitled to receive cash distributions from Plan M, payable as of the first day of the month following P's termination of employment (or as of the first day of any subsequent month, subject to the requirements of section 401(a)(9)), in the form of a single-sum distribution, or in substantially equal monthly installment payments over either 5, 10, 15, or 20 years. Plan M is amended so that, after the amendment is effective, P is no longer entitled to receive a distribution in the form of substantially equal monthly installment payments over 5, 10, or 15 years. However, after the amendment is effective, P continues to be entitled to receive cash distributions from Plan M, payable as of the first day of the month following P's termination of employment (or as of the first day of any subsequent month, except as required by section 401(a)(9)), in the form of a single-sum distribution or in substantially equal monthly installment payments over 20 years.

(ii) Plan M does not violate the requirements of section 411(d)(6) merely because the plan amendment has eliminated P's option to receive a distribution in the form of substantially equal monthly installment payments over 5, 10, or 15 years.

(5) Effective date. This paragraph (e) applies to plan amendments that are adopted and made effective after the date of publication of final regulations in the **Federal Register**.

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A-3. (a) * * *

(3) Waiver prohibition. In general, except as provided in paragraph (b) of this Q&A-3, a participant may not elect to waive section 411(d)(6) protected benefits. Thus, for example, the elimination of the defined benefit feature of a participant's benefit under a defined benefit plan by reason of a transfer of such benefits to a defined contribution plan pursuant to a participant election, at a time when the benefit is not distributable to the participant, violates section 411(d)(6).

(4) Direct rollovers. A direct rollover described in Q&A-3 of §1.401(a)(31)-1 that is paid to a qualified plan is not a transfer of assets and liabilities that must satisfy the requirements of section 414(l), and is not a transfer of benefits for purposes of applying the requirements under section 411(d)(6) and paragraph (a)(1) of this Q&A-3.

Therefore, for example, if such a direct rollover is made to another qualified plan, the receiving plan is not required to provide, with respect to amounts paid to it in a direct rollover, the same optional forms of benefit that were provided under the plan that made the direct rollover. See §1.401(a)(31)-1, Q&A-14.

(b) Elective transfers of benefits between defined contribution plans–(1) General rule. A transfer of a participant's entire benefit between qualified defined contribution plans (other than a direct transfer described in section 401(a)(31)) that results in the elimination or reduction of section 411(d)(6) protected benefits does not violate section 411(d)(6) if the following requirements are met:

(i) Voluntary election. The plan from which the benefits are transferred must provide that the transfer is conditioned upon a voluntary, fully-informed election by the participant to transfer the participant's entire benefit to the other qualified defined contribution plan. As an alternative to the transfer, the participant must be offered the opportunity to retain the participant's section 411(d)(6) protected benefits under the plan (or, if the plan is terminating, to receive any optional form of benefit for which the participant is eligible under the plan as required by section 411(d)(6)).

(ii) Types of plans to which transfers may be made. To the extent the benefits are transferred from a money purchase pension plan, the transferee plan must be a money purchase pension plan. To the extent the benefits being transferred are part of a qualified cash or deferred arrangement under section 401(k), the benefits must be transferred to a qualified cash or deferred arrangement under section 401(k). To the extent the benefits being transferred are part of an employee stock ownership plan as defined in section 4975(e)(7), the benefits must be transferred to another employee stock ownership plan. Benefits transferred from a profit-sharing plan other than from a qualified cash or deferred arrangement, or from a stock bonus plan other than an employee stock ownership plan, may be transferred to any type of defined contribution plan.

(iii) Circumstances under which transfers may be made. The transfer must be made in connection with an asset or stock acquisition, merger, or other similar transaction involving a change in employer of the employees of a trade or business (i.e., an acquisition or disposition within the meaning of §1.410(b)-2(f)) or in connection with the participant's transfer of employment to a different job for which service does not result in additional allocations under the transferor plan.

(2) Applicable qualification requirements. A transfer described in this paragraph (b) is a transfer of assets or liabilities within the meaning of section 414(l)(1) that must meet the requirements of section 414(l) and all other applicable qualification requirements. Thus, for example, if the survivor annuity requirements of sections 401(a)(11) and 417 apply to the plan from which the benefits are transferred, as described in this paragraph (b), but do not otherwise apply to the receiving plan, the requirements of sections 401(a)(11) and 417 must be met with respect to the transferred benefits under the receiving plan. In addition, the vesting provisions under the receiving plan must satisfy the requirements of section 401(a)(10) with respect to the amounts transferred.

(c) Elective transfers of certain distributable benefits between defined benefit plans or between defined contribution plans–(1) In general. A transfer of a participant's benefits that are distributable between qualified defined benefit plans, or between defined contribution plans (other than the portion of such a transfer that is a direct transfer described in section 401(a)(31)), that results in the elimination or reduction of section 411(d)(6) protected benefits does not violate section 411(d)(6) if–

(i) The voluntary election requirement of paragraph (b)(1)(i) of this Q&A-3 is met; and

(ii) The amount of the benefit transferred, together with the amount of a contemporaneous section 401(a)(31) transfer to the transferee plan, equals the entire nonforfeitable accrued benefit under the plan of the participant whose benefit is being transferred, calculated to be at least the greater of the single-sum distribution provided for under the plan for which the participant is eligible (if any) or the present value of the participant's accrued benefit payable at normal retirement age (calculated by using interest and mortality assumptions that satisfy the requirements of section 417(e) and subject to the limitations imposed by section 415).

(2) Treatment of transfer. The transfer of benefits pursuant to this paragraph (c) generally is treated as a distribution for purposes of section 401(a). For example, the transfer is subject to the cash-out rules of section 411(a)(7), the early termination requirements of section 411(d)(2), and the survivor annuity requirements of sections 401(a)(11) and 417. However, the transfer is not treated as a distribution for purposes of the minimum distribution requirements of section 401(a)(9).

(3) Distributable benefits. For purposes of this paragraph (c), a participant's benefits are distributable on a particular date if, on that date, the participant is eligible, under the terms of the plan from which the benefits are transferred, to receive an immediate distribution of these benefits from that plan under provisions of the plan not inconsistent with section 401(a).

(d) Status of elective transfer as optional form of benefit. A right to a transfer of benefits pursuant to the elective transfer rules of paragraph (b) or (c) of this Q&A-3 is an optional form of benefit under section 411(d)(6). The availability of such optional form is subject to the nondiscrimination requirements of section 401(a)(4). However, a plan will not be treated as failing to satisfy §1.401(a)(4)-4 merely because it restricts the transfer option to benefits that exceed the dollar limits on mandatory distributions that can be made without the consent of the participant under section 411(a)(11).

(e) Effective date. This Q&A-3 is applicable for transfers made after the date of publication of final regulations in the **Federal Register**.

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Robert E. Wenzel

Deputy Commissioner of Internal Revenue