Section 401.—Qualified Pension, Profit-sharing, and Stock Bonus Plans

26 CFR 1.401(f)–1: Certain custodial accounts on annuity contracts.

T.D. 8635

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Nonbank Trustee Net Worth Requirements

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains regulations that provide guidance to nonbank trustees with respect to the adequacy of net worth requirements that must be satisfied in order to be or remain an approved nonbank trustee. These regulations affect nonbank trustees and custodians of individual retirement accounts, and nonbank custodians of qualified plans and tax-sheltered annuities.

EFFECTIVE DATE: These regulations are effective December 20, 1995.

FOR FURTHER INFORMATION CONTACT: Marjorie Hoffman, (202) 622-6030 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On December 6, 1994, temporary regulations (TD 8570 [1994–2 C.B. 49]) under section 401 were published in the Federal Register (59 FR 62570). A notice of proposed rulemaking (EE–38–94 [1994–2 C.B. 49]), cross-referencing the temporary regulations, was published in the Federal Register (59 FR 62644) on the same day. The temporary regulations provide guidance on the adequacy of net worth requirements for nonbank trustees and custodians of individual retirement plans, and for nonbank custodians of custodial accounts of qualified plans and tax-sheltered annuities.

After consideration of all of the comments, the temporary regulations are replaced and the proposed regulations are adopted as revised by this Treasury decision. Because section 401(d)(1), under which § 1.401–12 was originally issued, was repealed by section 237(a) of the Tax Equity and Fiscal Responsibility Act of 1982, Public Law 97–248 (1982), these final regulations also move all the rules for nonbank trustees and custodians that were previously in § 1.401–12(n) to § 1.408–2.

Explanation of Provisions

The fiduciary conduct rules for nonbank trustees and custodians under longstanding Treasury regulations require nonbank trustees and custodians to maintain a minimum amount of net worth in order to qualify as an approved nonbank trustee or custodian. Under this requirement, the nonbank trustee or custodian's net worth must exceed the greater of a specified dollar amount or a percentage of the value of all assets held in fiduciary accounts of retirement plans. A primary objective of this adequacy-of-net-worth requirement has been to ensure that nonbank trustees and custodians maintain a level of solvency commensurate with their financial and fiduciary responsibilities.

Under the general net worth requirement, nonbank trustees and custodians may not accept new accounts unless their net worth exceeds the greater of $100,000 or four percent of the value of all assets held in fiduciary accounts. Additionally, nonbank trustees and custodians must take whatever steps are necessary (including the relinquishment of fiduciary accounts) to ensure that their net worth exceeds the greater of $50,000 or two percent of the value of all assets held by them in fiduciary accounts.

For passive nonbank trustees and custodians (qualified nonbank entities that have no discretion to direct the investment of assets), the percentage requirements are lower. Specifically, passive nonbank trustees and custodians may not accept new accounts unless their net worth exceeds the greater of $100,000 or two percent of the value of all assets held in fiduciary accounts. Additionally, they must take appropriate action (including the relinquishment of fiduciary accounts) to ensure that their net worth exceeds the greater of $50,000 or one percent of the value of assets held in their fiduciary accounts.

The proposed and temporary regulations provide a special rule for passive nonbank trustees and custodians that are broker-dealers and members of the Securities Investor Protection Corporation (SIPC). The proposed and temporary regulations provide that, to the extent that assets held in any fiduciary accounts are insured by SIPC in the event of the member's liquidation ($500,000 per account, $100,000 of which may be cash), the assets will be disregarded in determining the value of assets held in fiduciary accounts by the trustee or custodian for purposes of the percentage part of the net worth requirement.

The final regulations adopt the provisions of the proposed and temporary regulations. In addition, in response to comments, the final regulations extend the SIPC-related relief to all nonbank trustees and custodians that are broker-dealers and members of SIPC rather than limiting the relief to passive nonbank trustees and custodians. The final regulations provide that the

amount of the minimum net worth requirement for nonbank trustees and custodians that are SIPC members is reduced by either two percent of assets insured by SIPC (in the case of the minimum net worth requirement that applies to a trustee or custodian accepting additional accounts) or one percent of assets insured by SIPC (in the case of the minimum net worth requirement that must be satisfied to avoid a mandatory relinquishment of accounts). An example in the regulations illustrates this rule.

The final regulations also retain the rule in the proposed and temporary regulations that increased the initial net worth requirement for all nonbank trustees and custodians. The purpose of the rule is to better assure that the enterprises are sound and well-funded during their start-up period. This initial net worth requirement requires all new entities applying for nonbank trustee or custodian status to have a net worth of not less than $250,000 for the most recent taxable year preceding the applicant's initial application.

This new initial net worth requirement applies only to applications received after January 5, 1995. Previously approved nonbank trustees and custodians need only satisfy the ongoing net worth requirement.

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 Marjorie Hoffman, 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.

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Adoption of 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 is amended by adding an entry in numerical order to read as follows:

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

§ 1.401–12 also issued under 26 U.S.C. 401(d)(1). * * *

§§ 1.401–12 and 1.408–2 [Amended]

Par. 2. Paragraph (n) of § 1.401–12 is redesignated as paragraph (e) of § 1.408–2 and the authority citation immediately following § 1.401–12 is removed.

§ 1.401–12T [Removed]

Par. 3. Section 1.401–12T is removed.

§ 1.401(f)–1 [Amended]

Par. 4. Section 1.401(f)–1 is amended by:

1. Removing the language ''section 401(d)(1) and the regulations thereunder'' and adding ''§ 1.408–2(e)'' in its place in the last sentence of paragraph (b)(1)(ii).

2. Removing the language ''401(d)-(1) and adding ''408(n)'' in its place in paragraph (d)(1).

Par. 5. Section 1.408–2 is amended by:

1. Removing the language ''401(d)-(1)'' and adding ''408(n)'' in its place in paragraph (b)(2)(i).

2. Removing the language ''(b)(2)-(ii)'' and adding ''(e)'' in its place in paragraph (b)(2)(i).

3. Removing paragraph (b)(2)(ii).

4. Redesignating (b)(2)(iii) as (b)(2)-(ii)

5. Removing newly redesignated paragraphs (e)(1) and (e)(9).

6. Further redesignating paragraphs (e)(2) through (e)(8) as paragraphs (e)(1) through (e)(7), respectively.

7. Removing the language ''For the plan years to which this paragraph applies, the'' and adding ''The'' in its place, and removing the language ''(c)-(1)(i)'' and adding ''(b)'' in its place, in the first sentence of newly designated paragraph (e)(1).

8. Removing the language ''401'' and adding ''408'' in its place, and removing the language ''(n)(3) to (n)(7)'' and adding ''(e)(2) to (e)(6)'' in its place, in the second sentence of newly designated paragraph (e)(1).

9. Removing the language ''Commissioner of Internal Revenue, Attention: E:EP, Internal Revenue Service, Washington, D.C. 20224'' and adding ''the address prescribed by the Commissioner in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(*b*) of this chapter)'' in its place in the third sentence of newly designated paragraph (e)(1), in the last sentence of newly designated (e)(6)(9)(iv), and in the first sentence of newly designated (e)(6)(v)(B).

10. Removing the language ''(n)(8)'' and adding ''(e)(7)'' in its place in the last sentence of newly designated paragraph (e)(1).

11. Removing the language ''(n)(6)'' and adding ''(e)(5)'' in its place in newly designated paragraph (e)(2)(iv).

12. Redesignating newly designated paragraph (e)(5)(ii)(A) as paragraph (e)(5)(ii)(E).

13. Removing the language ''(n)(7)-(i)(A)'' and adding ''(e)(6)(i)(A)'' in its place in newly designated paragraph (e)(5)(ii)(B)(*2*) and in newly designated paragraph (e)(5)(ii)(C)(*2*).

14. Removing the language ''(n)(6)-(iii)(A)'' and adding ''(e)(5)(iii)(A)'' in its place in newly designated paragraph (e)(5)(iii)(B).

15. Removing the language ''(n)(6)-(vi)'' and adding ''(e)(5)(vi)'' in its place in newly designated paragraph (e)(5)(v)(A).

16. Removing the language ''(n)(6)-(viii)(C)'' and adding ''(e)(5)(viii)(C)'' in its place in newly designated paragraph (e)(5)(vi).

17. Removing the language ''(n)(3)-(v)'' and adding ''(e)(2)(v)'' in its place, and removing the language ''(n)(8)'' and adding ''(e)(7)'' in its place, in newly designated paragraph (e)(5)(viii).

18. Removing the language ''(n)(6)-(i)(A)(3)'' and adding ''(e)(5)(i)(A)-

(3)'' in its place, and removing the language ''(n)(5)(ii)(E)'' and adding ''(e)(4)(ii)(E)'' in its place, in the third sentence of newly designated paragraph (e)(6)(i)(A).

19. Removing the language ''(n)(7)-(iii)(A)(*3*)'' and adding ''(e)(6)(iii)(A)-(*3*)'' in its place in newly designated paragraph (e)(6)(iii)(C).

20. Revising newly redesignated paragraphs (e)(5)(ii)(A) and adding (e)(5)(ii)(D).

21. The revisions and addition read as follows:

§ 1.408–2 Individual retirement accounts

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(e) * * *

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(5) * * *

(ii) *Adequacy of net worth*—(A) *Initial net worth requirement*. In the case of applications received after January 5, 1995, no initial application will be accepted by the Commissioner unless the applicant has a net worth of not less than $250,000 (determined as of the end of the most recent taxable year). Thereafter, the applicant must satisfy the adequacy of net worth requirements of paragraph (e)(6)(ii)(B) and (C) of this section.

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(D) *Assets held by members of SIPC—1*) For purposes of satisfying the adequacy-of-net worth requirement of this paragraph, a special rule is provided for nonbank trustees that are members of the Securities Investor Protection Corporation (SIPC) created under the Securities Investor Protection Act of 1970 (SIPA)(15 U.S.C. § 78*aaa* et seq, as amended). The amount that the net worth of a nonbank trustee that is a member of SIPC must exceed is reduced by two percent for purposes of paragraph (e)(5)(ii)(B)(2), and one percent for purposes of paragraph (e)(5)-(ii)(C)(2), of the value of assets (determined on an account-by-account basis) held for the benefit of customers (as defined in 15 U.S.C. § 78fff–2(e)(4)) in fiduciary accounts by the nonbank trustee to the extent of the portion of each account that does not exceed the dollar limit on advances described in 15 U.S.C. § 78fff–3(a), as amended, that would apply to the assets in that account in the event of a liquidation proceeding under the SIPA.

(*2*) The provisions of this special rule for assets held in fiduciary accounts by members of SIPC are illustrated in the following example.

Example—(a) Trustee X is a broker-dealer and is a member of the Securities Investment Protection Corporation. Trustee X also has been approved as a nonbank trustee for individual retirement accounts (IRAs) by the Commissioner but not as a passive nonbank trustee. Trustee X is the trustee for four IRAs. The total assets of each IRA (for which Trustee X is the trustee) as of the most recent valuation date before the last day of Trustee X's taxable year ending in 1995 are as follows: the total assets for IRA–1 is $3,000,000 (all of which is invested in securities); the value of the total assets for IRA–2 is $500,000 ($200,000 of which is cash and $300,000 of which is invested in securities), the value of the total assets for IRA–3 is $400,000 (all of which is invested in securities); and the value of the total assets of IRA–4 is $200,000 (all of which is cash). The value of all assets held in fiduciary accounts, as defined in § 1.408–2(e)(6)(viii)(A), is $4,100,000.

(b) The dollar limit on advances described in 15 U.S.C. § 78fff–3(a) that would apply to the assets in each account in the event of a liquidation proceeding under the Securities Investor Protection Act of 1970 in effect as of the last day of Trustee X's taxable year ending in 1995 is $500,000 per account (no more that $100,000 of which is permitted to be cash). Thus, the dollar limit that would apply to IRA–1 is $500,000; the dollar limit for IRA–2 is $400,000 ($100,000 of the cash and the $300,000 of the value of the securities); the dollar limit for IRA–3 is $400,000 (the full value of the account because the value of the account is less than $500,000 and no portion of the account is cash); and the dollar limit for IRA–4 is $100,000 (the entire account is cash and the dollar limit per account for cash is $100,000). The aggregate dollar limits of the four IRAs is $1,400,000.

(c) For 1996, the amount determined under § 1.408–2(e)(6)(ii)(B) is determined as follows for Trustee X: (1) four percent of $4,100,000 equals $164,000; (2) two percent of $1,400,000 equals $28,000; and (3) $164,000 minus $28,000 equals $136,000. Thus, because $136,000 exceeds $100,000, the minimum net worth necessary for Trustee X to accept new accounts for 1996 is $136,000.

(d) For 1996, the amount determined under § 1.408–2(e)(6)(ii)(C) for Trustee X is determined as follows: (1) two percent of $4,100,000 equals $82,000; (2) one percent of $1,400,000 equals $14,000; and (3) $82,000 minus $14,000 equals $68,000. Thus, because $68,000 exceeds $50,000, the minimum net worth necessary for Trustee X to avoid a mandatory relinquishment of accounts for 1996 is $68,000.

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Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved December 12, 1995.

Leslie Samuels,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 19, 1995, 8:45 a.m., and published in the issue of the Federal Register for December 20, 1995, 60 F.R. 65547)