

DEFERRED COMPENSATION

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SECTION 72 -- Annuities

(q) 10-percent penalty for premature distributions from annuity contracts

(1) Imposition of penalty. If any taxpayer receives any amount under an annuity contract, the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income.

(2) Subsection not to apply to certain distributions. Paragraph (1) shall not apply to any distribution--

(A) made on or after the date on which the taxpayer attains age 59 1/2,

(B) made on or after the death of the holder (or, where the holder is not an individual, the death of the primary annuitant (as defined in subsection (s)(6)(B))), ***

(t) 10-percent additional tax on early distributions from qualified retirement plans.

(1) **Imposition of additional tax.** If any taxpayer receives any amount from a qualified retirement plan (as defined in section 4974(c)), the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income.

(2) **Subsection not to apply to certain distributions.** Except as provided in paragraphs (3) and (4), paragraph (1) shall not apply to any of the following distributions:

(A) **In general.** Distributions which are--

(i) made on or after the date on which the employee attains *age 59 1/2* ,

(ii) made to a beneficiary (or to the estate of the employee) on or *after the death of the employee*.

(iii) attributable to the employee's being *disabled* within the meaning of subsection (m)(7),

(iv) part of a series of *substantially equal periodic payments* (not less frequently than annually) made for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of such employee and his designated beneficiary,

(v) made to an employee after *separation from service after attainment of age 55*,

(vi) dividends paid with respect to stock of a corporation which are described in section 404(k), or

(vii) made on account of a levy under section 6331 on the qualified retirement plan.

(B) Medical expenses. Distributions made to the employee (other than distributions described in subparagraph (A), (C), or (D)) to the extent such distributions do not exceed the amount allowable as a deduction under section 213 to the employee for amounts paid during the taxable year for medical care (determined without regard to whether the employee itemizes deductions for such taxable year).

(C) Payments to alternate payees pursuant to qualified domestic relations orders. Any distribution to an alternate payee pursuant to a qualified domestic relations order (within the meaning of section 414(p)(1)).

(D) Distributions to unemployed individuals for health insurance premiums.

(i) In general. Distributions from an individual retirement plan to an individual after separation from employment--

(I) if such individual has received unemployment compensation for 12 consecutive weeks under any Federal or State unemployment

compensation law by reason of such separation,
(II) if such distributions are made during any taxable year during which such unemployment compensation is paid or the succeeding taxable year, and

(III) to the extent such distributions do not exceed the amount paid during the taxable year for insurance described in section 213(d)(1)(D) with respect to the individual and the individual's spouse and dependents (as defined in section 152).

(ii) Distributions after reemployment. Clause (i) shall not apply to any distribution made after the individual has been employed for at least 60 days after the separation from employment to which clause (i) applies.

(iii) Self-employed individuals. To the extent provided in regulations, a self-employed individual shall be treated as meeting the requirements of clause (i)(I) if, under Federal or State law, the individual would have received unemployment compensation but for the fact the individual was self-employed.

(E) Distributions from individual retirement plans for *higher education expenses* [Max: \$10,000 avoids penalty]. Distributions to an individual from an individual retirement plan to the extent such distributions do not exceed the qualified higher education expenses (as defined in paragraph (7)) of the taxpayer for the taxable year. Distributions shall not be taken into account under the preceding sentence if such distributions are described in subparagraph (A), (C), or (D) or to the extent paragraph (1) does not apply to such distributions by reason of subparagraph (B).

(F) Distributions from certain plans for *first home purchases* [Max: \$10,000 avoids penalty]. Distributions to an individual from an individual retirement plan which are qualified first-time homebuyer distributions (as defined in paragraph (8)).

Distributions shall not be taken into account under the preceding sentence if such distributions are described in subparagraph (A), (C), (D), or (E) or to the extent paragraph (1) does not apply to such distributions by reason of subparagraph (B).

(3) Limitations.

(A) Certain exceptions not to apply to *individual retirement plans*. Subparagraphs (A)(v) ["quit after age 55"] and (C) ["QDRO"] of paragraph (2) shall not apply to distributions from an individual retirement plan.

(B) Periodic payments under *qualified plans* must begin after separation. Paragraph (2)(A)(iv) shall not apply to any amount paid from a trust described in section 401(a) which is exempt from tax under section 501(a) or from a contract described in section 72(e)(5)(D)(ii) unless the series of payments begins after the employee separates from service. [*but ... periodic payments from IRAs can be gin even if still employed*]

(4) Change in substantially equal payments....

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(u) Treatment of annuity contracts not held by natural persons.

(1) In general. If any annuity contract is held by a person who is not a natural person--

(A) such contract shall not be treated as an annuity contract for purposes of this subtitle (other than subchapter L), and

(B) the income on the contract for any taxable year of the policyholder shall be treated as ordinary income received or accrued by the owner during such taxable year.

For purposes of this paragraph, holding by a trust or other entity as an agent for a natural person shall not be taken into account.

(2) Income on the contract.

(A) In general. For purposes of paragraph (1), the term "income on the contract" means, with respect to any taxable year of the policyholder, the excess of--

(i) the sum of the net surrender value of the contract as of the close of the taxable year plus all distributions under the contract received during the taxable year or any prior taxable year, reduced by

(ii) the sum of the amount of net premiums under the contract for the taxable year and prior taxable years and amounts includible in

gross income for prior taxable years with respect to such contract under this subsection.

Where necessary to prevent the avoidance of this subsection, the Secretary may substitute "fair market value of the contract" for "net surrender value of the contract" each place it appears in the preceding sentence....

http://www.ia-mag.com/issues/2005_1/departments/4598-1.html

"MyMax DB plans" in 2005

<http://www.mymaxplan.com/> (has nice graph)

Sec. 83. Property transferred in connection with performance of services.

(a) General rule. If, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of--
{AMOUNT}>> (1) *the fair market value of such property (determined without regard to any restriction other than a restriction which by its terms will never lapse)* at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, *over*
(2) *the amount (if any) paid for such property,*

{WHEN}>> shall be included in the gross income of the person who performed such services *in the first taxable year in which the rights* of the person having the beneficial interest in such property *are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable*. The preceding sentence shall not apply if such person *sells or otherwise disposes of such property* in an arm's length transaction before his rights in such property become transferable or not subject to a substantial risk of forfeiture.

(b) Election to include in gross income in year of transfer.

(1) In general. Any person who performs services in connection with which property is transferred to any person may elect to include in his gross income, for the taxable year in which such property is transferred, the excess of--
(A) the fair market value of such property at the time of transfer (determined without regard to any restriction other than a restriction which by its terms will never lapse), over

(B) the amount (if any) paid for such property. If such election is made, subsection (a) shall not apply with respect to the transfer of such property, and if such property is subsequently forfeited, no deduction shall be allowed in respect of such forfeiture.

(2) Election. An election under paragraph (1) with respect to any transfer of property shall be made in such manner as the Secretary prescribes and shall be made not later than 30 days after the date of such transfer. Such election may not be revoked except with the consent of the Secretary.

(c) Special rules. For purposes of this section--
(1) *Substantial risk of forfeiture.* The rights of a person in property are subject to a substantial risk of forfeiture if such person's rights to full enjoyment of such property are conditioned upon the future performance of substantial services by any individual.

(2) *Transferability of property.* The rights of a person in property are transferable only if the rights in such property of any transferee are not subject to a substantial risk of forfeiture.

(3) Sales which may give rise to suit under Section 16(b) of the Securities Exchange Act of 1934. So long as the sale of property at a profit could subject a person to suit under section 16(b) of the Securities Exchange Act of 1934], such person's rights in such property are--

(A) subject to a substantial risk of forfeiture, and
(B) not transferable.

(4) For purposes of determining an individual's basis in property transferred in connection with the performance of services, rules similar to the rules of section 72 shall apply.

(d) Certain restrictions which will never lapse.

(1) Valuation. *In the case of property subject to a restriction which by its terms will never lapse, and which allows the transferee to sell such property only at a price determined under a formula, the price so determined shall be deemed to be the fair market value of the property unless established to the contrary by the Secretary, and the burden of proof shall be on the Secretary with respect to such value.*

(2) Cancellation. If, in the case of property

subject to a restriction which by its terms will never lapse, the restriction is canceled, then, unless the taxpayer establishes--

(A) that such cancellation was not compensatory, and

(B) that the person, if any, who would be allowed a deduction if the cancellation were treated as compensatory, will treat the transaction as not compensatory, as evidenced in such manner as the Secretary shall prescribe by regulations,

the excess of the fair market value of the property (computed without regard to the restrictions) at the time of cancellation over the sum of--

(C) the fair market value of such property (computed by taking the restriction into account) immediately before the cancellation, and

(D) the amount, if any, paid for the cancellation, shall be treated as compensation for the taxable year in which such cancellation occurs.

(e) Applicability of section. This section shall *not* apply to--

(1) a transaction to which section 421 applies,

- (2) a transfer to or from a trust described in section 401(a) or a transfer under an annuity plan which meets the requirements of section 404(a)(2),
- (3) the transfer of an option without a readily ascertainable fair market value,
- (4) the transfer of property pursuant to the exercise of an option with a readily ascertainable fair market value at the date of grant, or
- (5) group-term life insurance to which section 79 applies.

(f) Holding period. In determining the period for which the taxpayer has held property to which subsection (a) applies, there shall be included only the period beginning at the first time his rights in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier.

(g) Certain exchanges. * * *

(h) Deduction by employer. In the case of a transfer of property to which this section applies or a cancellation of a restriction described in

subsection (d), there *shall be allowed as a deduction under section 162* to the person for whom were performed the services in connection with which such property was transferred, *an amount equal to the amount included under subsection (a), (b), or (d)(2) in the gross income of the person who performed such services.* Such deduction shall be allowed for the taxable year of such person in which or with which ends the taxable year in which such amount is included in the gross income of the person who performed such services.

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§ 401. Qualified pension, profit-sharing, and stock bonus plans.

(a) Requirements for qualification. A trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section--

(1) if contributions are made to the trust by such employer, or employees, or both, or by another employer who is entitled to

deduct his contributions under section 404(a)(3)(B) (relating to deduction for contributions to profit-sharing and stock bonus plans), or by a charitable remainder trust pursuant to a qualified gratuitous transfer (as defined in section 664(g)(1)), for the purpose of distributing to such employees or their beneficiaries the corpus and income of the fund accumulated by the trust in accordance with such plan;

(2) if under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries (but this paragraph shall not be construed, in the case of a multiemployer plan, to prohibit the return of a contribution within 6 months after the plan administrator determines that the contribution was made by a mistake of fact or law (other than a mistake relating to whether the plan is described in section 401(a) or the trust which is part of such plan is exempt from taxation under section 501(a), or the return of any withdrawal liability payment determined to be an overpayment within 6 months of such determination);

(3) if the plan of which such trust is a part satisfies the requirements of section 410 (relating to minimum participation standards); and

(4) if the **contributions or benefits** provided under the plan do not discriminate in favor of highly compensated employees (within the meaning of section 414(q)). For purposes of this paragraph, there shall be excluded from consideration employees described in section 410(b)(3)(A) and (C).

(5) Special rules relating to nondiscrimination requirements.

(A) Salaried or clerical employees. A classification shall not be considered discriminatory within the meaning of paragraph (4) or section 410(b)(2)(A)(i) merely because it is limited to salaried or

clerical employees.

(B) Contributions and benefits may bear uniform relationship to compensation.

A plan shall not be considered discriminatory within the meaning of paragraph (4) merely because the contributions or benefits of, or on behalf of, the employees under the plan bear a uniform relationship to the compensation (within the meaning of section 414(s)) of such employees.

(C) Certain disparity permitted. A plan shall not be considered discriminatory within the meaning of paragraph (4) merely because the contributions or benefits of, or on behalf of, the employees under the plan favor highly compensated employees (as defined in section 414(q)) in the manner permitted under subsection (l).

(D) Integrated defined benefit plan.

(i) In general. A defined benefit plan shall not be considered discriminatory within the meaning of paragraph (4) merely because the plan provides that the employer-derived accrued retirement benefit for any participant under the plan may not exceed the excess (if any) of--

(I) the participant's final pay with the employer, over

(II) the employer-derived retirement benefit created under Federal law attributable to service by the participant with the employer.

For purposes of this clause, the employer-derived retirement benefit created under Federal law shall be treated as accruing ratably over 35 years.

(ii) Final pay. For purposes of this subparagraph, the participant's final pay is the compensation (as defined in section 414(q)(4)) paid to the participant by the employer for any year--

(I) which ends during the 5-year period ending with the year in which the participant separated from service for the employer, and

(II) for which the participant's total compensation from the employer was highest.

(E) 2 or more plans treated as single plan. For purposes of determining whether 2 or more plans of an employer satisfy the requirements of paragraph (4) when considered as a single plan--

(i) Contributions. If the amount of contributions on behalf of the

employees allowed as a deduction under section 404 for the taxable year with respect to such plans, taken together, bears a uniform relationship to the compensation (within the meaning of section 414(s)) of such employees, the plans shall not be considered discriminatory merely because the rights of employees to, or derived from, the employer contributions under the separate plans do not become nonforfeitable at the same rate.

(ii) Benefits. If the employees' rights to benefits under the separate plans do not become nonforfeitable at the same rate, but the levels of benefits provided by the separate plans satisfy the requirements of regulations prescribed by the Secretary to take account of the differences in such rates, the plans shall not be considered discriminatory merely because of the difference in such rates.

(F) Social security retirement age. For purposes of testing for discrimination under paragraph (4)--

(i) the social security retirement age (as defined in section 415(b)(8)) shall be treated as a uniform retirement age, and

(ii) subsidized early retirement benefits and joint and survivor annuities shall not be treated as being unavailable to employees on the same terms merely because such benefits or annuities are based in whole or in part on an employee's social security retirement age (as so defined).

(G) State and local governmental plans. Paragraphs (3) and (4) shall not apply to a governmental plan (within the meaning of section 414(d)) maintained by a State or local government or political subdivision thereof (or agency or instrumentality thereof).

(6) A plan shall be considered as meeting the requirements of paragraph (3) during the whole of any taxable year of the plan if on one day in each quarter it satisfied such requirements.

(7) A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part satisfies the requirements of section 411 (relating to minimum vesting standards).

(8) A trust forming part of a defined benefit plan shall not constitute a qualified trust under this section unless the plan

provides that forfeitures must not be applied to increase the benefits any employee would otherwise receive under the plan.

(9) Required distributions.

(A) In general. A trust shall not constitute a qualified trust under this subsection unless the plan provides that the entire interest of each employee--

(i) will be distributed to such employee not later than the required beginning date, or

(ii) will be distributed, beginning not later than the required beginning date, in accordance with regulations, over the life of such employee or over the lives of such employee and a designated beneficiary (or over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and a designated beneficiary).

(B) Required distribution where employee dies before entire interest is distributed.

(i) Where distributions have begun under subparagraph (A)(ii). A trust shall not constitute a qualified trust under this section unless the plan provides that if--

(I) the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii), and

(II) the employee dies before his entire interest has been distributed to him,

the remaining portion of such interest will be distributed at least as rapidly as under the method of distributions being used under subparagraph (A)(ii) as of the date of his death.

(ii) 5-year rule for other cases. A trust shall not constitute a qualified trust under this section unless the plan provides that, if an employee dies before the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii), the entire interest of the employee will be distributed within 5 years after the death of such employee.

(iii) Exception to 5-year rule for certain amounts payable over

life of beneficiary. If--

(I) any portion of the employee's interest is payable to (or for the benefit of) a designated beneficiary,
(II) such portion will be distributed (in accordance with regulations) over the life of such designated beneficiary (or over a period not extending beyond the life expectancy of such beneficiary), and
(III) such distributions begin not later than 1 year after the date of the employee's death or such later date as the Secretary may by regulations prescribe,
for purposes of clause (ii), the portion referred to in subclause (I) shall be treated as distributed on the date on which such distributions begin.

(iv) Special rule for surviving spouse of employee. If the designated beneficiary referred to in clause (iii)(I) is the surviving spouse of the employee--

(I) the date on which the distributions are required to begin under clause (iii)(III) shall not be earlier than the date on which the employee would have attained age 70 1/2 , and
(II) if the surviving spouse dies before the distributions to such spouse begin, this subparagraph shall be applied as if the surviving spouse were the employee.

(C) Required beginning date. For purposes of this paragraph--

(i) In general. The term "required beginning date" means April 1 of the calendar year following the later of--

(I) the calendar year in which the employee attains age 70 1/2 , or
(II) the calendar year in which the employee **retires**.

(ii) Exception. Subclause (II) of clause (i) shall not apply--

(I) except as provided in section 409(d), in the case of an employee who is a 5-percent owner (as defined in section 416) with respect to the plan year ending in the calendar year in which the employee attains age 70 1/2 , or

(II) for purposes of section 408 (a)(6) or (b)(3).

(iii) Actuarial adjustment. In the case of an employee to whom clause (i)(II) applies who retires in a calendar year after the

calendar year in which the employee attains age 70 1/2 , the employee's accrued benefit shall be actuarially increased to take into account the period after age 70 1/2 in which the employee was not receiving any benefits under the plan.

(iv) Exception for governmental and church plans. Clauses (ii) and (iii) shall not apply in the case of a governmental plan or church plan. For purposes of this clause, the term "church plan" means a plan maintained by a church for church employees, and the term "church" means any church (as defined in section 3121(w)(3)(A)) or qualified church-controlled organization (as defined in section 3121(w)(3)(B)).

(D) Life expectancy. For purposes of this paragraph, the life expectancy of an employee and the employee's spouse (other than in the case of a life annuity) may be redetermined but not more frequently than annually.

(E) **Designated beneficiary.** For purposes of this paragraph, the term "designated beneficiary" means any individual designated as a beneficiary by the employee.

(F) Treatment of payments to children. Under regulations prescribed by the Secretary, for purposes of this paragraph, any amount paid to a child shall be treated as if it had been paid to the surviving spouse if such amount will become payable to the surviving spouse upon such child reaching majority (or other designated event permitted under regulations).

(G) Treatment of incidental death benefit distributions. For purposes of this title, any distribution required under the incidental death benefit requirements of this subsection shall be treated as a distribution required under this paragraph.

(10) Other requirements.

(A) Plans benefiting owner-employees. In the case of any plan which provides contributions or benefits for employees some or all of whom are owner-employees (as defined in subsection (c)(3)), a trust forming part of such plan shall constitute a qualified trust under this section only if the requirements of subsection (d) are also met.

(B) Top-heavy plans.

(i) In general. In the case of any top-heavy plan, a trust forming part of such plan shall constitute a qualified trust under this section only if the requirements of section 416 are met.

(ii) Plans which may become top-heavy. Except to the extent provided in regulations, a trust forming part of a plan (whether or not a top-heavy plan) shall constitute a qualified trust under this section only if such plan contains provisions--

(I) which will take effect if such plan becomes a top-heavy plan, and

(II) which meet the requirements of section 416.

(iii) Exemption for governmental plans. This subparagraph shall not apply to any governmental plan.

(11) Requirement of joint and survivor annuity and preretirement survivor annuity.

(A) In general. In the case of any plan to which this paragraph applies, except as provided in section 417, a trust forming part of such plan shall not constitute a qualified trust under this section unless--

(i) in the case of a vested participant who does not die before the annuity starting date, the accrued benefit payable to such participant is provided in the form of a qualified joint and survivor annuity, and

(ii) in the case of a vested participant who dies before the annuity starting date and who has a surviving spouse, a qualified preretirement survivor annuity is provided to the surviving spouse of such participant.

(B) Plans to which paragraph applies. This paragraph shall apply to--

(i) any defined benefit plan,

(ii) any defined contribution plan which is subject to the funding standards of section 412, and

(iii) any participant under any other defined

contribution plan unless--

(I) such plan provides that the participant's nonforfeitable accrued benefit (reduced by any security interest held by the plan by reason of a loan outstanding to such participant) **is payable in full, on the death of the participant, to the participant's**

surviving spouse (or, if there is no surviving spouse or the surviving spouse consents in the manner required under section 417(a)(2), to a designated beneficiary),

(II) such participant does not elect a payment of benefits in the form of a life annuity, and

(III) with respect to such participant, such plan is not a direct or indirect transferee (in a transfer after December 31, 1984) of a plan which is described in clause (i) or (ii) or to which this clause applied with respect to the participant.

Clause (iii)(III) shall apply only with respect to the transferred assets (and income therefrom) if the plan separately accounts for such assets and any income therefrom.

(C) Exception for certain ESOP benefits.

(i) In general. In the case of--

(I) a tax credit employee stock ownership plan (as defined in section 409(a)), or

(II) an employee stock ownership plan (as defined in section 4975(e)(7)),

subparagraph (A) shall not apply to that portion of the employee's accrued benefit to which the requirements of section 409(h) apply.

(ii) Nonforfeitable benefit must be paid in full, etc. In the case of any participant, clause (i) shall apply only if the requirements of subclauses (I), (II), and (III) of subparagraph (B)(iii) are met with respect to such participant.

(D) Special rule where participant and spouse married less than 1 year. A plan shall not be treated as failing to meet the requirements of subparagraphs (B)(iii) or (C) merely because the plan provides that benefits will not be payable to the surviving spouse of the participant unless the participant and such spouse had been married

throughout the 1-year period ending on the earlier of the participant's annuity starting date or the date of the participant's death.

(E) Exception for plans described in section 404(c). This paragraph shall not apply to a plan which the Secretary has determined is a plan described in section 404(c) (or a continuation thereof) in which participation is substantially limited to individuals who, before January 1, 1976, ceased employment covered by the plan.

(F) Cross reference. For--

(i) provisions under which participants may elect to waive the requirements of this paragraph, and

(ii) other definitions and special rules for purposes of this paragraph,

see section 417.

(12) A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that in the case of any merger or consolidation with, or transfer of assets or liabilities to, any other plan after September 2, 1974, each participant in the plan would (if the plan then terminated) receive a benefit immediately after the merger, consolidation, or transfer which is equal to or greater than the benefit he would have been entitled to receive immediately before the merger, consolidation, or transfer (if the plan had then terminated). The preceding sentence does not apply to any multiemployer plan with respect to any transaction to the extent that participants either before or after the transaction are covered under a multiemployer plan to which title IV of the Employee Retirement Income Security Act of 1974 [[29 USCS §§ 1301](#) et seq.] applies.

(13) Assignment and alienation.

(A) In general. A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that benefits provided under the plan *may not be assigned or*

alienated. For purposes of the preceding sentence, there shall not be taken into account any voluntary and revocable assignment of not to exceed 10 percent of any benefit payment made by any participant who is receiving benefits under the plan unless the assignment or alienation is made for purposes of defraying plan administration costs. For purposes of this paragraph a loan made to a participant or beneficiary shall not be treated as an assignment or alienation if such loan is secured by the participant's accrued nonforfeitable benefit and is exempt from the tax imposed by section 4975 (relating to tax on prohibited transactions) by reason of section 4975(d)(1). This paragraph shall take effect on January 1, 1976 and shall not apply to assignments which were irrevocable on September 2, 1974.

(B) Special rules for domestic relations orders. Subparagraph (A) shall apply to the creation, assignment, or recognition of a right to any benefit payable with respect to a participant pursuant to a domestic relations order, *except* that subparagraph (A) shall not apply if the order is determined to be a *qualified domestic relations order*.

(C) Special rule for certain judgments and settlements.

Subparagraph (A) shall not apply to any offset of a participant's benefits provided under a plan against an amount that the participant is ordered or required to pay to the plan if--

(i) the order or requirement to pay arises--

(I) *under a judgment of conviction for a crime involving such plan,*

....

SECTION 414(p): Qualified domestic relations order

defined. For purposes of this subsection and section 401(a)(13)--

(1) In general. (A) **Qualified domestic relations order.** The

term "qualified domestic relations order" means a *domestic relations order*--

(i) which creates or recognizes the existence of an alternate payee's right to, or assigns to an alternate payee the right to, receive all or a

portion of the benefits payable with respect to a participant under a plan, and

(ii) with respect to which the requirements of paragraphs (2) and (3) are met.

(B) Domestic relations order. The term "domestic relations order" means any judgment, decree, or order (including approval of a property settlement agreement) which--

(i) relates to the provision of child support, alimony payments, or marital property rights to a spouse, former spouse, child, or other dependent of a participant, and

(ii) is made pursuant to a State domestic relations law (including a community property law).

(2) Order must clearly specify certain facts. A domestic relations order meets the requirements of this paragraph only if such order clearly specifies--

(A) the name and the last known mailing address (if any) of the participant and the name and mailing address of each alternate payee covered by the order,

(B) the amount or percentage of the participant's benefits to be paid by the plan to each such alternate payee, or the manner in which such amount or percentage is to be determined,

(C) the number of payments or period to which such order applies, and

(D) each plan to which such order applies.

(3) Order may not alter amount, form, etc., of benefits. A

domestic relations order meets the requirements of this paragraph only if such order--

(A) does not require a plan to provide any type or form of benefit, or any option, not otherwise provided under the plan,

(B) does not require the plan to provide increased benefits

(determined on the basis of actuarial value), and

(C) does not require the payment of benefits to an alternate payee which are required to be paid to another alternate payee under

another order previously determined to be a qualified domestic relations order.

(4) Exception for certain payments made after earliest retirement age.

(A) In general. A domestic relations order shall not be treated as failing to meet the requirements of subparagraph (A) of paragraph (3) solely because such order requires that payment of benefits be made to an alternate payee--

(i) in the case of any payment before a participant has separated from service, on or after the date on which the participant attains (or would have attained) the earliest retirement age,

(ii) as if the participant had retired on the date on which such payment is to begin under such order (but taking into account only the present value of the benefits actually accrued and not taking into account the present value of any employer subsidy for early retirement), and

(iii) in any form in which such benefits may be paid under the plan to the participant (other than in the form of a joint and survivor annuity with respect to the alternate payee and his or her subsequent spouse).

For purposes of clause (ii), the interest rate assumption used in determining the present value shall be the interest rate specified in the plan or, if no rate is specified, 5 percent.

(B) Earliest retirement age. For purposes of this paragraph, the term "earliest retirement age" means the earlier of--

(i) the date on which the participant is entitled to a distribution under the plan, or

(ii) the later of--

(I) the date the participant attains age 50, or

(II) the earliest date on which the participant could begin receiving benefits under the plan if the participant separated from service.

(5) Treatment of former spouse as surviving spouse for purposes of

determining survivor benefits. To the extent provided in any qualified domestic relations order--

(A) the former spouse of a participant shall be treated as a surviving spouse of such participant for purposes of sections 401(a)(11) and 417 (and any spouse of the participant shall not be treated as a spouse of the participant for such purposes), and (B) if married for at least 1 year, the surviving former spouse shall be treated as meeting the requirements of section 417(d).

(6) Plan procedures with respect to orders.

(A) Notice and determination by administrator. In the case of any domestic relations order received by a plan--

(i) the plan administrator shall promptly notify the participant and each alternate payee of the receipt of such order and the plan's procedures for determining the qualified status of domestic relations orders, and

(ii) within a reasonable period after receipt of such order, the plan administrator shall determine whether such order is a qualified domestic relations order and notify the participant and each alternate payee of such determination.

(B) Plan to establish reasonable procedures. Each plan shall establish reasonable procedures to determine the qualified status of domestic relations orders and to administer distributions under such qualified orders.

(7) Procedures for period during which determination is being made....

(8) Alternate payee defined. The term "alternate payee" means any spouse, former spouse, child or other dependent of a participant who is recognized by a domestic relations order as having a right to receive all, or a portion of, the benefits payable under a plan with respect to such participant.

(9) Subsection not to apply to plans to which section 401(a)(13) does not apply. This subsection shall not apply to any plan to which section 401(a)(13) does not apply. For purposes of this title, except as provided in regulations, any distribution from an annuity

contract under section 403(b) pursuant to a qualified domestic relations order shall be treated in the same manner as a distribution from a plan to which section 401(a)(13) applies.

(10) Waiver of certain distribution requirements. *With respect to the requirements of subsections (a) and (k) of section 401, section 403(b), section 409(d), and section 457(d),* a plan shall not be treated as failing to meet such requirements solely by reason of payments to an alternative payee pursuant to a qualified domestic relations order.

(II) under a civil judgment (including a consent order or decree) entered by a court in an action brought in connection with a violation (or alleged violation) of part 4 of subtitle B of title I of the Employee Retirement Income Security Act of 1974 [[29 USCS §§ 1101](#) et seq.], or

(III) pursuant to a settlement agreement between the Secretary of Labor and the participant, or a settlement agreement between the Pension Benefit Guaranty Corporation and the participant, in connection with a violation (or alleged violation) of part 4 of such subtitle [[29 USCS §§ 1101](#) et seq.] by a fiduciary or any other person,

(ii) the judgment, order, decree, or settlement agreement expressly provides for the offset of all or part of the amount ordered or required to be paid to the plan against the participant's benefits provided under the plan, and

(iii) in a case in which the survivor annuity requirements of section 401(a)(11) apply with respect to distributions from the plan to the participant, if the participant has a spouse at the time at which the offset is to be made--

(I) either such spouse has consented in writing to such offset and such consent is witnessed by a notary public or representative of the plan (or it is established to the satisfaction of a plan representative that such consent may not be obtained by reason of

circumstances described in section 417(a)(2)(B)), or an election to waive the right of the spouse to either a qualified joint and survivor annuity or a qualified preretirement survivor annuity is in effect in accordance with the requirements of section 417(a),

(II) such spouse is ordered or required in such judgment, order, decree, or settlement to pay an amount to the plan in connection with a violation of part 4 of such subtitle [[29 USCS §§ 1101 et seq.](#)], or

(III) in such judgment, order, decree, or settlement, such spouse retains the right to receive the survivor annuity under a qualified joint and survivor annuity provided pursuant to section 401(a)(11)(A)(i) and under a qualified preretirement survivor annuity provided pursuant to section 401(a)(11)(A)(ii), determined in accordance with subparagraph (D).

A plan shall not be treated as failing to meet the requirements of this subsection, subsection (k), section 403(b), or section 409(d) solely by reason of an offset described in this subparagraph.

(D) Survivor annuity.

(i) In general. The survivor annuity described in subparagraph (C)(iii)(III) shall be determined as if--

(I) the participant terminated employment on the date of the offset,

(II) there was no offset,

(III) the plan permitted commencement of benefits only on or after normal retirement age,

(IV) the plan provided only the minimum-required qualified joint and survivor annuity, and

(V) the amount of the qualified preretirement survivor annuity under the plan is equal to the amount of the survivor annuity payable under the minimum-required qualified joint and survivor annuity.

(ii) Definition. For purposes of this subparagraph, the term "minimum-required qualified joint and survivor annuity" means the qualified joint and survivor annuity which is the actuarial equivalent of the participant's accrued benefit (within the meaning of section 411(a)(7)) and under which the survivor annuity is 50

percent of the amount of the annuity which is payable during the joint lives of the participant and the spouse.

(14) A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that, unless the participant otherwise elects, the payment of benefits under the plan to the participant will begin not later than the 60th day after the latest of the close of the plan year in which--

(A) the date on which the participant attains the earlier of age 65 or the normal retirement age specified under the plan,

(B) occurs the 10th anniversary of the year in which the participant commenced participation in the plan, or

(C) the participant terminates his service with the employer.

In the case of a plan which provides for the payment of an early retirement benefit, a trust forming a part of such plan shall not constitute a qualified trust under this section unless a participant who satisfied the service requirements for such early retirement benefit, but separated from the service (with any nonforfeitable right to an accrued benefit) before satisfying the age requirement for such early retirement benefit, is entitled upon satisfaction of such age requirement to receive a benefit not less than the benefit to which he would be entitled at the normal retirement age, actuarially, reduced under regulations prescribed by the Secretary.

(15) a trust shall not constitute a qualified trust under this section unless under the plan of which such trust is a part--

(A) in the case of a participant or beneficiary who is receiving benefits under such plan, or

(B) in the case of a participant who is separated from the service and who has nonforfeitable rights to benefits,

such benefits are not decreased by reason of any increase in the benefit levels payable under title II of the Social Security Act [[42 USCS §§ 401](#) et seq.] or any increase in the wage base under such title II, if such increase takes place after September 2, 1974, or (if

later) the earlier of the date of first receipt of such benefits or the date of such separation, as the case may be.

(16) A trust shall not constitute a qualified trust under this section if the plan of which such trust is a part provides for benefits or contributions which exceed the limitations of section 415.

(17) Compensation limit.

(A) In general. A trust shall not constitute a qualified trust under this section unless, under the plan of which such trust is a part, the annual compensation of each employee taken into account under the plan for any year does not exceed \$ 200,000.

(B) Cost-of-living adjustment. The Secretary shall adjust annually the \$ 200,000 amount in subparagraph (A) for increases in the cost-of-living at the same time and in the same manner as adjustments under section 415(d); except that the base period shall be the calendar quarter beginning July 1, 2001, and any increase which is not a multiple of \$ 5,000 shall be rounded to the next lowest multiple of \$ 5,000.

(18) Repealed.

(19) A trust shall not constitute a qualified trust under this section if under the plan of which such trust is a part any part of a participant's accrued benefit derived from employer contributions (whether or not otherwise nonforfeitable), is forfeitable solely because of withdrawal by such participant of any amount attributable to the benefit derived from contributions made by such participant. The preceding sentence shall not apply to the accrued benefit of any participant unless, at the time of such withdrawal, such participant has a nonforfeitable right to at least 50 percent of such accrued benefit (as determined under section 411). The first sentence of this paragraph shall not apply to the extent that an accrued benefit is permitted to be forfeited in accordance with section 411(a)(3)(D)(iii) (relating to proportional forfeitures of

benefits accrued before September 2, 1974, in the event of withdrawal of certain mandatory contributions).

(20) A trust forming part of a pension plan shall not be treated as failing to constitute a qualified trust under this section merely because the pension plan of which such trust is a part makes 1 or more distributions within 1 taxable year to a distributee on account of a termination of the plan of which the trust is a part, or in the case of a profit-sharing or stock bonus plan, a complete discontinuance of contributions under such plan. This paragraph shall not apply to a defined benefit plan unless the employer maintaining such plan files a notice with the Pension Benefit Guaranty Corporation (at the time and in the manner prescribed by the Pension Benefit Guaranty Corporation) notifying the Corporation of such payment or distribution and the Corporation has approved such payment or distribution or, within 90 days after the date on which such notice was filed, has failed to disapprove such payment or distribution. For purposes of this paragraph, rules similar to the rules of section 402(a)(6)(B) (as in effect before its repeal by section 521 of the Unemployment Compensation Amendments of 1992) shall apply.

(21) Repealed.

(22) If a defined contribution plan (other than a profit-sharing plan)--

(A) is established by an employer whose stock is not readily tradable on an established market, and

(B) after acquiring securities of the employer, *more than 10 percent of the total assets of the plan are securities of the employer,*

any trust forming part of such plan shall not constitute a qualified trust under this section unless the plan meets the requirements of subsection (e) of section 409. The requirements of subsection (e) of section 409 shall not apply to any employees of an employer who are participants in any defined contribution plan established

and maintained by such employer if the stock of such employer is not readily tradable on an established market and the trade or business of such employer consists of publishing on a regular basis a newspaper for general circulation. For purposes of the preceding sentence, subsections (b), (c), (m), and (o) of section 414 shall not apply except for determining whether stock of the employer is not readily tradable on an established market.

(23) A stock bonus plan shall not be treated as meeting the requirements of this section unless such plan meets the requirements of subsections (h) and (o) of section 409, except that in applying section 409(h) for purposes of this paragraph, the term "employer securities" shall include any securities of the employer held by the plan.

(24) Any group trust which otherwise meets the requirements of this section shall not be treated as not meeting such requirements on account of the participation or inclusion in such trust of the moneys of any plan or governmental unit described in section 818(a)(6).

(25) Requirement that actuarial assumptions be specified. A defined benefit plan shall not be treated as providing definitely determinable benefits unless, whenever the amount of any benefit is to be determined on the basis of actuarial assumptions, such assumptions are specified in the plan in a way which precludes employer discretion.

(26) Additional participation requirements.

(A) In general. In the case of a trust which is a part of a defined benefit plan, such trust shall not constitute a qualified trust under this subsection unless on each day of the plan year such trust benefits at least the lesser of--

(i) 50 employees of the employer, or

(ii) the greater of--

(I) 40 percent of all employees of the employer, or

(II) 2 employees (or if there is only 1 employee, such employee).

(B) Treatment of excludable employees.

(i) In general. A plan may exclude from consideration under this

paragraph employees described in paragraphs (3) and (4)(A) of section 410(b).

(ii) Separate application for certain excludable employees. If employees described in section 410(b)(4)(B) are covered under a plan which meets the requirements of subparagraph (A) separately with respect to such employees, such employees may be excluded from consideration in determining whether any plan of the employer meets such requirements if--

(I) the benefits for such employees are provided under the same plan as benefits for other employees,

(II) the benefits provided to such employees are not greater than comparable benefits provided to other employees under the plan, and

(III) no highly compensated employee (within the meaning of section 414(q)) is included in the group of such employees for more than 1 year.

(C) Eligibility to participate. In the case of contributions under section 401(k) or 401(m), employees who are eligible to contribute (or may elect to have contributions made on their behalf) shall be treated as benefiting under the plan.

(D) Special rule for collective bargaining units. Except to the extent provided in regulations, a plan covering only employees described in section 410(b)(3)(A) may exclude from consideration any employees who are not included in the unit or units in which the covered employees are included.

(E) Paragraph not to apply to multiemployer plans. Except to the extent provided in regulations, this paragraph shall not apply to employees in a multiemployer plan (within the meaning of section 414(f)) who are covered by collective bargaining agreements.

(F) Special rule for certain dispositions or acquisitions. Rules similar to the rules of section 410(b)(6)(C) shall apply for purposes of this paragraph.

(G) Separate lines of business. At the election of the employer and with the consent of the Secretary, this paragraph may be applied separately with respect to each separate line of business of the

employer. For purposes of this paragraph, the term "separate line of business" has the meaning given such term by section 414(r) (without regard to paragraph (2)(A) or (7) thereof).

(H) Exception for State and local governmental plans. This paragraph shall not apply to a governmental plan (within the meaning of section 414(d)) maintained by a State or local government or political subdivision thereof (or agency or instrumentality thereof).

(I) Regulations. The Secretary may by regulation provide that any separate benefit structure, any separate trust, or any other separate arrangement is to be treated as a separate plan for purposes of applying this paragraph.

(27) Determinations as to profit-sharing plans.

(A) Contributions need not be based on profits. The determination of whether the plan under which any contributions are made is a profit-sharing plan shall be made without regard to current or accumulated profits of the employer and without regard to whether the employer is a tax-exempt organization.

(B) Plan must designate type. In the case of a plan which is intended to be a money purchase pension plan or a profit-sharing plan, a trust forming part of such plan shall not constitute a qualified trust under this subsection unless the plan designates such intent at such time and in such manner as the Secretary may prescribe.

(28) Additional requirements relating to employee stock ownership plans.

(A) In general. In the case of a trust which is part of an employee stock ownership plan (within the meaning of section 4975(e)(7)) or a plan which meets the requirements of section 409(a), such trust shall not constitute a qualified trust under this section unless such plan meets the requirements of subparagraphs (B) and (C).

(B) Diversification of investments.

(i) In general. A plan meets the requirements of this subparagraph

if each qualified participant in the plan may elect within 90 days after the close of each plan year in the qualified election period to ***direct the plan as to the investment of at least 25 percent of the participant's account in the plan*** (to the extent such portion exceeds the amount to which a prior election under this subparagraph applies). ***In the case of the election year in which the participant can make his last election, the preceding sentence shall be applied by substituting "50 percent" for "25 percent"***.

(ii) Method of meeting requirements. A plan shall be treated as meeting the requirements of clause (i) if--

(I) the portion of the participant's account covered by the election under clause (i) is distributed within 90 days after the period during which the election may be made, or

(II) the plan offers at least 3 investment options (not inconsistent with regulations prescribed by the Secretary) to each participant making an election under clause (i) and within 90 days after the period during which the election may be made, the plan invests the portion of the participant's account covered by the election in accordance with such election.

(iii) Qualified participant. For purposes of this subparagraph, the term "qualified participant" means ***any employee who has completed at least 10 years of participation under the plan and has attained age 55.***

(29) Security required upon adoption of plan amendment resulting in significant underfunding.

(A) In general. If--

(i) **a defined benefit plan** (other than a multiemployer plan) to which the requirements of section 412 apply adopts an amendment an effect of which is to increase current liability under the plan for a plan year, and

(ii) the funded current liability percentage of the plan for the plan year in which the amendment takes effect is less than 60 percent, including the amount of the unfunded current liability under the

plan attributable to the plan amendment, the trust of which such plan is a part shall not constitute a qualified trust under this subsection unless such amendment does not take effect until the contributing sponsor (or any member of the controlled group of the contributing sponsor) provides security to the plan....

(B) Form of security. ...

(30) Limitations on elective deferrals. In the case of a trust which is part of a plan under which elective deferrals (within the meaning of section 402(g)(3)) may be made with respect to any individual during a calendar year, such trust shall not constitute a qualified trust under this subsection unless the plan provides that the amount of such deferrals under such plan and all other plans, contracts, or arrangements of an employer maintaining such plan may not exceed the amount of the limitation in effect under section 402(g)(1)(A) for taxable years beginning in such calendar year.

(31) Direct transfer of eligible rollover distributions.

(A) In general. A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that if the distributee of any eligible rollover distribution--

(i) elects to have such distribution paid directly to an eligible retirement plan, and

(ii) specifies the eligible requirement plan to which such distribution is to be paid (in such form and at such time as the plan administrator may prescribe),

such distribution shall be made in the form of a direct trustee-to-trustee transfer to the eligible retirement plan so specified.

(B) Certain mandatory distributions [Caution: Pursuant to § 657(d) of P.L. 107-16 (note to this section), this subparagraph applies to distributions made after final regulations implementing § 657(c)(2)(A) of P.L. 107-16 (note to this section) are prescribed.].

(i) In general. In case of a trust which is part of an eligible plan,

such trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that if--

(I) a distribution described in clause (ii) in excess of \$ 1,000 is made, and

(II) the distributee does not make an election under subparagraph (A) and does not elect to receive the distribution directly, the plan administrator shall make such transfer to an individual retirement plan of a designated trustee or issuer and shall notify the distributee in writing (either separately or as part of the notice under section 402(f)) that the distribution may be transferred to another individual retirement plan.

(ii) Eligible plan. For purposes of clause (i), the term "eligible plan" means a plan which provides that any nonforfeitable accrued benefit for which the present value (as determined under section 411(a)(11)) does not exceed \$ 5,000 shall be immediately distributed to the participant.

(C) Limitation. Subparagraphs (A) and (B) shall apply only to the extent that the eligible rollover distribution would be includible in gross income if not transferred as provided in subparagraph (A) (determined without regard to sections 402(c), 403(a)(4), 403(b)(8), and 457(e)(16)). The preceding sentence shall not apply to such distribution if the plan to which such distribution is transferred--

(i) is a qualified trust which is part of a plan which is a defined contribution plan and agrees to separately account for amounts so transferred, including separately accounting for the portion of such distribution which is includible in gross income and the portion of such distribution which is not so includible, or

(ii) is an eligible retirement plan described in clause (i) or (ii) of section 402(c)(8)(B).

(D) Eligible rollover distribution. For purposes of this paragraph, the term "eligible rollover distribution" has the meaning given such term by section 402(f)(2)(A).

(E) Eligible retirement plan. For purposes of this paragraph, the term "eligible retirement plan" has the meaning given such term by

section 402(c)(8)(B), except that a qualified trust shall be considered an eligible retirement plan only if it is a defined contribution plan, the terms of which permit the acceptance of rollover distributions.

(32) Treatment of failure to make certain payments if plan has liquidity shortfall.

(A) In general. ...

(33) Prohibition on benefit increases while sponsor is in bankruptcy.

(A) In general. ...

(34) Benefits of missing participants on plan termination. In the case of a plan covered by title IV of the Employee Retirement Income Security Act of 1974, a trust forming part of such plan shall not be treated as failing to constitute a qualified trust under this section merely because the pension plan of which such trust is a part, upon its termination, transfers benefits of missing participants to the Pension Benefit Guaranty Corporation in accordance with section 4050 of such Act.

Paragraphs (11), (12), (13), (14), (15), (19), and (20) shall apply only in the case of a plan to which section 411 (relating to minimum vesting standards) applies without regard to subsection (e)(2) of such section.

(b) Certain retroactive changes in plan. A stock bonus, pension, profit-sharing, or annuity plan shall be considered as satisfying the requirements of subsection (a) for the period beginning with the date on which it was put into effect, or for the period beginning with the earlier of the date on which there was adopted or put into effect any amendment which caused the plan to fail to satisfy such requirements, and ending with the time prescribed by law for filing

the return of the employer for his taxable year in which such plan or amendment was adopted (including extensions thereof) or such later time as the Secretary may designate, if all provisions of the plan which are necessary to satisfy such requirements are in effect by the end of such period and have been made effective for all purposes for the whole of such period.

(c) Definitions and rules relating to self-employed individuals and owner-employees.

(e) Repealed.

(f) Certain custodial accounts and contracts. For purposes of this title, a custodial account, an annuity contract, or a contract (other than a life, health or accident, property, casualty, or liability insurance contract) issued by an insurance company qualified to do business in a State shall be treated as a qualified trust under this section if--

(1) the custodial account or contract would, except for the fact that it is not a trust, constitute a qualified trust under this section, and
(2) in the case of a custodial account the assets thereof are held by a bank (as defined in section 408(n)) or another person who demonstrates, to the satisfaction of the Secretary, that the manner in which he will hold the assets will be consistent with the requirements of this section.

For purposes of this title, in the case of a custodial account or contract treated as a qualified trust under this section by reason of this subsection, the person holding the assets of such account or holding such contract shall be treated as the trustee thereof.

(g) Annuity defined.

(h) Medical, etc., benefits for retired employees and their spouses and dependents. Under regulations prescribed by the

Secretary, and subject to the provisions of section 420, a pension or annuity plan may provide for the payment of benefits for sickness, accident, hospitalization, and medical expenses of retired employees, their spouses and their dependents, but only if--

- (1) such benefits are subordinate to the retirement benefits provided by the plan,
- (2) a separate account is established and maintained for such benefits,
- (3) the employer's contributions to such separate account are reasonable and ascertainable,
- (4) it is impossible, at any time prior to the satisfaction of all liabilities under the plan to provide such benefits, for any part of the corpus or income of such separate account to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of such benefits,
- (5) notwithstanding the provisions of subsection (a)(2), upon the satisfaction of all liabilities under the plan to provide such benefits, any amount remaining in such separate account must, under the terms of the plan, be returned to the employer, and
- (6) in the case of an employee who is a key employee, a separate account is established and maintained for such benefits payable to such employee (and his spouse and dependents) and such benefits (to the extent attributable to plan years beginning after March 31, 1984, for which the employee is a key employee) are only payable to such employee (and his spouse and dependents) from such separate account.

For purposes of paragraph (6), the term "key employee" means any employee, who at any time during the plan year or any preceding plan year during which contributions were made on behalf of such employee, is or was a key employee as defined in section 416(i). In no event shall the requirements of paragraph (1) be treated as met if the aggregate actual contributions for medical benefits, when added to actual contributions for life insurance protection under the plan, exceed 25 percent of the total actual contributions to the plan

(other than contributions to fund past service credits) after the date on which the account is established.

(i) Certain union-negotiated pension plans.

(j) Repealed.

(k) Cash or deferred arrangements.

(1) General rule. A profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan shall not be considered as not satisfying the requirements of subsection (a) merely because the plan includes a qualified cash or deferred arrangement.

(2) Qualified cash or deferred arrangement. A qualified cash or deferred arrangement is any arrangement which is part of a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan which meets the requirements of subsection (a)--

(A) under which a covered employee may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee, or to the employee directly in cash;

(B) under which amounts held by the trust which are attributable to *employer contributions made pursuant to the employee's election--*

(i) may not be distributable to participants or other beneficiaries earlier than--

(I) severance from employment, death, or disability,

(II) an event described in paragraph (10),

(III) in the case of a profit-sharing or stock bonus plan, the

attainment of age 59 1/2 , or

(IV) in the case of contributions to a profit-sharing or stock bonus plan to which section 402(e)(3) applies, upon *hardship* of the employee, and

(ii) will not be distributable merely by reason of the completion of a stated period of participation or the lapse of a fixed number of years;

(C) which provides that an employee's right to his accrued benefit derived from employer contributions made to the trust pursuant to his election is nonforfeitable, and

(D) which does not require, as a condition of participation in the arrangement, that an employee complete a period of service with the employer (or employers) maintaining the plan extending beyond the period permitted under section 410(a)(1) (determined without regard to subparagraph (B)(i) thereof).

(3) Application of participation and discrimination standards.

(A) A cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement unless--

(i) those employees eligible to benefit under the arrangement satisfy the provisions of section **410(b)(1)** [**broad coverage --70% of work force**], and

(ii) the *actual deferral percentage* for eligible *highly compensated employees* (as defined in paragraph (5)) for the plan year bears a relationship to the actual deferral percentage for all other eligible employees for the preceding plan year which meets either of the **following tests:**

(I) The actual deferral percentage for the group of eligible highly

compensated employees is not more than the actual deferral percentage of all other eligible employees multiplied by 1.25.
(II) The excess of the actual deferral percentage for the group of eligible highly compensated employees over that of all other eligible employees is not more than 2 percentage points, and the actual deferral percentage for the group of eligible highly compensated employees is not more than the actual deferral percentage of all other eligible employees multiplied by 2.

If 2 or more plans which include cash or deferred arrangements are considered as 1 plan for purposes of section 401(a)(4) or 410(b), the cash or deferred arrangements included in such plans shall be treated as 1 arrangement for purposes of this subparagraph.

If any highly compensated employee is a participant under 2 or more cash or deferred arrangements of the employer... ** ** * ** **
** ** **

HIGHLY COMPENSATED EMPLOYEES:

Sec. 414(q):

(q) Highly compensated employee.

(1) In general. The term "highly compensated employee" means any employee who--

(A) was a 5-percent owner at any time during the year or the preceding year, or

(B) for the preceding year--

(i) had compensation from the employer in excess of \$ 80,000 [\$95,000 in 2005], and

(ii) if the employer elects the application of this clause for such preceding year, was in the **top-paid group** of employees for such

preceding year.

The Secretary shall adjust the \$ 80,000 amount under subparagraph (B) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter ending September 30, 1996.

(2) 5-percent owner. [Means own more than 5% of business]

An employee shall be treated as a 5-percent owner for any year if at any time during such year such employee was a 5-percent owner (as defined in section 416(i)(1)) of the employer.

(3) Top-paid group. An employee is in the top-paid group of employees for any year if such employee is in the group consisting of the top 20 percent of the employees when ranked on the basis of compensation paid during such year.

(4) Compensation. For purposes of this subsection, the term "compensation" has the meaning given such term by section 415(c)(3).

(5) Excluded employees...

**** ** * ** ****

SECTION 401(k)(4):

(4) Other requirements.

(A) Benefits (other than matching contributions) must not be contingent on election to defer. A cash or deferred arrangement of any employer shall not be treated as a qualified cash or deferred arrangement if any other benefit is conditioned (directly or indirectly) on the employee electing to have the employer make or not make contributions under the arrangement in lieu of receiving cash. The preceding sentence shall not apply to any matching contribution (as defined in section 401(m)) made by reason of such

an election.

(B) Eligibility of state and local governments and tax-exempt organizations.

(i) Tax-exempts eligible. Except as provided in clause (ii), any organization exempt from tax under this subtitle may include a qualified cash or deferred arrangement as part of a plan maintained by it.

(ii) Governments ineligible. A cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement if it is part of a plan maintained by a State or local government or political subdivision thereof, or any agency or instrumentality thereof. This clause shall not apply to a rural cooperative plan or to a plan of an employer described in clause (iii).

(8) Arrangement not disqualified if excess contributions distributed.

(A) In general. A cash or deferred arrangement shall not be treated as failing to meet the requirements of clause (ii) of paragraph (3)(A) for any plan year if, before the close of the following plan year--

(i) the amount of the excess contributions for such plan year (and any income allocable to such contributions) is distributed, or
(ii) to the extent provided in regulations, the employee elects to treat the amount of the excess contributions as an amount distributed to the employee and then contributed by the employee to the plan.

Any distribution of excess contributions (and income) may be made without regard to any other provision of law.

(B) Excess contributions. For purposes of subparagraph (A), the term "excess contributions" means, with respect to any plan year, the excess of--

(i) the aggregate amount of employer contributions actually paid over to the trust on behalf of highly compensated employees for such plan year, over

(ii) the maximum amount of such contributions permitted under

the limitations of clause (ii) of paragraph (3)(A) (determined by reducing contributions made on behalf of highly compensated employees in order of the actual deferral percentages beginning with the highest of such percentages).

(C) Method of distributing excess contributions. Any distribution of the excess contributions for any plan year shall be made to highly compensated employees on the basis of the amount of contributions by, or on behalf of, each of such employees.

(D) Additional tax under section 72(t) not to apply. No tax shall be imposed under section 72(t) on any amount required to be distributed under this paragraph.

(E) Treatment of matching contributions forfeited by reason of excess deferral or contribution. For purposes of paragraph (2)(C), a matching contribution (within the meaning of subsection (m)) shall not be treated as forfeitable merely because such contribution is forfeitable if the contribution to which the matching contribution relates is treated as an excess contribution under subparagraph (B), an excess deferral under section 402(g)(2)(A), or an excess aggregate contribution under section 401(m)(6)(B).

(F) Cross reference.

For excise tax on certain excess contributions, see section 4979.

(9) Compensation. For purposes of this subsection, the term "compensation" has the meaning given such term by section 414(s).

(10) Distributions upon termination of plan.

(A) In general. An event described in this subparagraph is the termination of the plan without establishment or maintenance of another defined contribution plan (other than an employee stock ownership plan as defined in section 4975(e)(7)).

(B) Distributions must be lump sum distributions.

(i) In general. A termination shall not be treated as described in subparagraph (A) with respect to any employee unless the employee receives a lump sum distribution by reason of the termination.

(ii) Lump-sum distribution. For purposes of this subparagraph, the

term "lump-sum distribution" has the meaning given such term by section 402(e)(4)(D) (without regard to subclauses (I), (II), (III), and (IV) of clause (i) thereof). Such term includes a distribution of an annuity contract from--

- (I) a trust which forms a part of a plan described in section 401(a) and which is exempt from tax under section 501(a), or
- (II) an annuity plan described in section 403(a).

(11) Adoption of *simple* plan to meet nondiscrimination tests.

(A) In general. A cash or deferred arrangement maintained by an eligible employer shall be treated as meeting the requirements of paragraph (3)(A)(ii) if such arrangement meets--

- (i) the contribution requirements of subparagraph (B),
- (ii) the exclusive plan requirements of subparagraph (C), and
- (iii) the vesting requirements of section 408(p)(3).

(B) Contribution requirements.

(i) In general. The requirements of this subparagraph are met if, under the arrangement--

(I) an employee may elect to have the employer make elective contributions for the year on behalf of the employee to a trust under the plan in an amount which is expressed as a percentage of compensation of the employee but which in no event exceeds the amount in effect under section 408(p)(2)(A)(ii),

(II) the employer is required to make a matching contribution to the trust for the year in an amount equal to so much of the amount the employee elects under subclause (I) as does not exceed 3 percent of compensation for the year, and

(III) no other contributions may be made other than contributions described in subclause (I) or (II).

(ii) *Employer may elect 2-percent nonelective contribution.* ...

(12) Alternative methods of meeting nondiscrimination requirements....

(1) Permitted disparity in plan contributions or benefits.

(1) In general. The requirements of this subsection are met with respect to a plan if--

(A) in the case of a defined contribution plan, the requirements of paragraph (2) are met, and

(B) in the case of a defined benefit plan, the requirements of paragraph (3) are met.

(2) Defined contribution plan.

(A) In general. A defined contribution plan meets the requirements of this paragraph if the excess contribution percentage does not exceed the base contribution percentage by more than the lesser of--

-

(i) the base contribution percentage, or

(ii) the greater of--

(I) 5.7 percentage points, or

(II) the percentage equal to the portion of the rate of tax under section 3111(a) (in effect as of the beginning of the year) which is attributable to old-age insurance.

(B) Contribution percentages.--

(i) Excess contribution percentage.

The term "excess contribution percentage" means the percentage of compensation which is contributed by the employer under the plan with respect to that portion of each participant's compensation in excess of the integration level.

(ii) Base contribution percentage. The term "base contribution percentage" means the percentage of compensation contributed by the employer under the plan with respect to that portion of each participant's compensation not in excess of the integration level.

(3) Defined benefit plan. A defined benefit plan meets the requirements of this paragraph if--

(A) Excess plans.

(i) In general. In the case of a plan other than an offset plan--

(I) the excess benefit percentage does not exceed the base benefit percentage by more than the maximum excess allowance,
(II) any optional form of benefit, preretirement benefit, actuarial factor, or other benefit or feature provided with respect to compensation in excess of the integration level is provided with respect to compensation not in excess of such level, and
(III) benefits are based on average annual compensation.

(ii) Benefit percentages. For purposes of this subparagraph, the excess and base benefit percentages shall be computed in the same manner as the excess and base contribution percentages under paragraph (2)(B), except that such determination shall be made on the basis of benefits attributable to employer contributions rather than contributions.

(B) Offset plans. In the case of an offset plan, the plan provides that--

(i) a participant's accrued benefit attributable to employer contributions (within the meaning of section 411(c)(1)) may not be reduced (by reason of the offset

§ 410. Minimum participation standards.

(a) Participation.

(1) Minimum age and service conditions.

(A) General rule. A trust shall not constitute a qualified trust under section 401(a) if the plan of which it is a part requires, as a condition of participation in the plan, that an employee complete a period of service with the employer or employers maintaining the plan extending beyond the later of the following dates--

(i) the date on which the employee attains the age of 21; or
(ii) the date on which he completes 1 year of service.

(B) Special rules for certain plans.

(i) In the case of any plan which provides that after not more

than 2 years of service each participant has a right to 100 percent of his accrued benefit under the plan which is nonforfeitable (within the meaning of section 411) at the time such benefit accrues, clause (ii) of subparagraph (A) shall be applied *by substituting '2 years of service' for '1 year of service'*.

(ii) In the case of any plan maintained exclusively for employees of an **educational institution** (as defined in section 170(b)(1)(A)(ii)) by an employer which is exempt from tax under section 501(a) which provides that each participant having at least 1 year of service has a right to 100 percent of his accrued benefit under the plan which is nonforfeitable (within the meaning of section 411) at the time such benefit accrues, clause (i) of subparagraph (A) shall be applied **by substituting '26' for '21'**. This clause shall not apply to any plan to which clause (i) applies.

(2) Maximum age conditions. A trust shall not constitute a qualified trust under section 401(a) if the plan of which it is a part excludes from participation (on the basis of age) employees who have attained a specified age.

(3) Definition of year of service.

(A) General rule. For purposes of this subsection, the term 'year of service' means a 12-month period during which the employee has **not less than 1,000 hours of service**. For purposes of this paragraph, computation of any 12-month period shall be made with reference to the date on which the employee's employment commenced, except that, under regulations prescribed by the Secretary of Labor, such computation may be made by reference to the first day of a

plan year in the case of an employee who does not complete 1,000 hours of service during the 12-month period beginning on the date his employment commenced.

(B) Seasonal industries. In the case of any seasonal industry where the customary period of employment is less than 1,000 hours during a calendar year, the term 'year of service' shall be such period as may be determined under regulations prescribed by the Secretary of Labor.

(C) Hours of service. For purposes of this subsection, the term 'hour of service' means a time of service determined under regulations prescribed by the Secretary of Labor.

(D) Maritime industries. For purposes of this subsection, in the case of any maritime industry, 125 days of service shall be treated as 1,000 hours of service. The Secretary of Labor may prescribe regulations to carry out this subparagraph.

(4) Time of participation. A plan shall be treated as not meeting the requirements of paragraph (1) unless it provides that any employee who has satisfied the minimum age and service requirements specified in such paragraph, and who is otherwise entitled to participate in the plan, commences participation in the plan *no later than the earlier of--*
(A) the first day of the first plan year beginning after the date on which such employee satisfied such requirements, or
(B) the date 6 months after the date on which he satisfied such requirements,
unless such employee was separated from the service before the date referred to in subparagraph (A) or (B), whichever is applicable.

(5) Breaks in service.

(A) General rule. Except as otherwise provided in

subparagraphs (B), (C), and (D), all years of service with the employer or employers maintaining the plan shall be taken into account in computing the period of service for purposes of paragraph (1).

(B) Employees under 2-year 100 percent vesting. In the case of any employee who has any 1-year break in service (as defined in section 411(a)(6)(A)) under a plan to which the service requirements of clause (i) of paragraph (1)(B) apply, if such employee has not satisfied such requirements, service before such break shall not be required to be taken into account.

(C) 1-year break in service. In computing an employee's period of service for purposes of paragraph (1) in the case of any participant who has any 1-year break in service (as defined in section 411(a)(6)(A)), service before such break shall not be required to be taken into account under the plan until he has completed a year of service (as defined in paragraph (3)) after his return.

(D) Nonvested participants.

(i) In general. For purposes of paragraph (1), in the case of a nonvested participant, years of service with the employer or employers maintaining the plan before any period of consecutive 1-year breaks in service shall not be required to be taken into account in computing the period of service if the number of consecutive 1-year breaks in service within such period equals or exceeds the greater of--

(I) 5, or

(II) the aggregate number of years of service before such period.

(ii) Years of service not taken into account. If any years of service are not required to be taken into account by reason of a period of breaks in service to which clause (i) applies, such years of service shall not be taken into account in applying clause (i) to a subsequent period of breaks in service.

(iii) Nonvested participant defined. For purposes of clause (i), the term 'nonvested participant' means a participant who does not have any nonforfeitable right under the plan to an accrued benefit derived from employer contributions.

(E) Special rule for maternity or paternity absences.--

(i) General rule. In the case of each individual who is absent from work for any period--

(I) by reason of the pregnancy of the individual,

(II) by reason of the birth of a child of the individual,

(III) by reason of the placement of a child with the individual in connection with the adoption of such child by such individual, or

(IV) for purposes of caring for such child for a period beginning immediately following such birth or placement, the plan shall treat as hours of service, solely for purposes of determining under this paragraph whether a 1-year break in service (as defined in section 411(a)(6)(A)) has occurred, the hours described in clause (ii).

(ii) Hours treated as hours of service. The hours described in this clause are--

(I) the hours of service which otherwise would normally have been credited to such individual but for such absence, or

(II) in any case in which the plan is unable to determine the hours described in subclause (I), 8 hours of service per day of such absence,

except that the total number of hours treated as hours of service under this clause by reason of any such pregnancy or placement shall not exceed 501 hours.

(iii) Year to which hours are credited. The hours described in clause (ii) shall be treated as hours of service as provided in this subparagraph--

(I) only in the year in which the absence from work begins, if a participant would be prevented from incurring a 1-year break

in service in such year solely because the period of absence is treated as hours of service as provided in clause (i); or
(II) in any other case, in the immediately following year.

(b) Minimum coverage requirements.

(1) In general. A trust shall not constitute a qualified trust under section 401(a) unless such trust is designated by the employer as part of a plan which meets 1 of the following requirements:

(A) The plan benefits at least 70 percent of employees who are not highly compensated employees.

(B) The plan benefits--

(i) a percentage of employees who are not highly compensated employees which is at least 70 percent of
(ii) the percentage of highly compensated employees benefiting under the plan.

(C) The plan meets the requirements of paragraph (2).

(2) Average benefit percentage test.

(A) In general. A plan shall be treated as meeting the requirements of this paragraph if--

(i) the plan benefits such employees as qualify under a classification set up by the employer and found by the Secretary not to be discriminatory in favor of highly compensated employees, and

(ii) the average benefit percentage for employees who are not highly compensated employees is at least 70 percent of the

average benefit percentage for highly compensated employees.

(B) Average benefit percentage. For purposes of this paragraph, the term 'average benefit percentage' means, with respect to any group, the average of the benefit percentages calculated separately with respect to each employee in such group (whether or not a participant in any plan).

(C) Benefit percentage. For purposes of this paragraph--
(i) In general. The term 'benefit percentage' means the employer-provided contribution or benefit of an employee under all qualified plans maintained by the employer, expressed as a percentage of such employee's compensation (within the meaning of section 414(s)). * * *

(4) Exclusion of employees not meeting age and service requirements.

(A) In general. If a plan--

(i) prescribes minimum age and service requirements as a condition of participation, and

(ii) excludes all employees not meeting such requirements from participation,

then such employees shall be excluded from consideration for purposes of this subsection.

(B) Requirements may be met separately with respect to excluded group. If employees not meeting the minimum age or service requirements of subsection (a)(1) (without regard to subparagraph (B) thereof) are covered under a plan of the employer which meets the requirements of paragraph (1) separately with respect to such employees, such employees may be excluded from consideration in determining whether

any plan of the employer meets the requirements of paragraph (1).

(C) Requirements not treated as being met before entry date. An employee shall not be treated as meeting the age and service requirements described in this paragraph until the first date on which, under the plan, any employee with the same age and service would be eligible to commence participation in the plan.

(5) Line of business exception.

(A) In general. If, under section 414(r), an employer is treated as operating separate lines of business for a year, the employer may apply the requirements of this subsection for such year separately with respect to employees in each separate line of business.

(B) Plan must be nondiscriminatory. Subparagraph (A) shall not apply with respect to any plan maintained by an employer unless such plan benefits such employees as qualify under a classification set up by the employer and found by the Secretary not to be discriminatory in favor of highly compensated employees.

(6) Definitions and special rules. For purposes of this subsection--

(A) Highly compensated employee. The term 'highly compensated employee' has the meaning given such term by section 414(q).

(c) Application of participation standards to certain plans.

(d) Election by church to have participation, vesting, funding, etc., provisions apply.

§ 411. Minimum vesting standards.

(a) General rule. A trust shall not constitute a qualified trust under section 401(a) unless the plan of which such trust is a part provides that an employee's right to his normal retirement benefit is nonforfeitable upon the attainment of normal retirement age (as defined in paragraph (8)) and in addition satisfies the requirements of paragraphs (1), (2), and (11) of this subsection and the requirements of subsection (b)(3), and also satisfies, in the case of a defined benefit plan, the requirements of subsection (b)(1) and, in the case of a defined contribution plan, the requirements of subsection (b)(2).

(1) Employee contributions. Except as provided in paragraph (12), a plan satisfies the requirements of this paragraph if an employee's rights in his accrued benefit derived from his own contributions are *nonforfeitable*.

(2) Employer contributions. A plan satisfies the requirements of this paragraph if it satisfies the requirements of subparagraph (A) or (B).

(A) 5-year vesting. A plan satisfies the requirements of this subparagraph if an employee who has completed at least 5 years of service has a nonforfeitable right to 100 percent of the employee's accrued benefit derived from employer contributions.

(B) 3 to 7 year vesting. A plan satisfies the requirements of this subparagraph if an employee has a nonforfeitable right to a percentage of the employee's accrued benefit derived from employer contributions determined under the following table:

The nonforfeitable

Years of service: percentage is:

3	.....	20
4	.....	40
5	.....	60
6	.....	80
7 or more	.....	100.

(C) [Deleted]

(3) Certain permitted forfeitures, suspensions, etc. * * *

(G) Treatment of matching contributions forfeited by reason of excess deferral or contribution. A matching contribution (within the meaning of section 401(m)) shall not be treated as forfeitable merely because such contribution is forfeitable if the contribution to which the matching contribution relates is treated as an excess contribution under section 401(k)(8)(B), an excess deferral under section 402(g)(2)(A), or an excess aggregate contribution under section 401(m)(6)(B).

(4) Service included in determination of nonforfeitable percentage. * * *

(5) Year of service.

(A) General rule. For purposes of this subsection, except as provided in subparagraph (C), the term "year of service" means a calendar year, plan year, or other 12-consecutive month period designated by the plan (and not prohibited under regulations prescribed by the Secretary of Labor) during which the participant has completed 1,000 hours of service.

(B) Hours of service. For purposes of this subsection, the term "hours of service" has the meaning provided by section 410(a)(3)(C).

(C) Seasonal industries. In the case of any seasonal industry where the customary period of employment is less than 1,000 hours during a calendar year, the term "year of service" shall be such period as may be determined under regulations prescribed by the Secretary of Labor.

(D) Maritime industries. For purposes of this subsection, in the case of any maritime industry, 125 days of service shall be treated as 1,000 hours of service. The Secretary of Labor may prescribe regulations to carry out the purposes of this subparagraph.

(6) Breaks in service.

(A) Definition of 1-year break in service. For purposes of this paragraph, the term "1-year break in service" means a calendar year, plan year, or other 12-consecutive-month period designated by the plan (and not prohibited under regulations prescribed by the Secretary of Labor) during which *the participant has not completed more than 500 hours of service.*

(B) 1 year of service after 1-year break in service. For purposes of paragraph (4), in the case of any employee who has any 1-year break in service, years of service before such break shall not be required to be taken into account until he has completed a year of service after his return.

(C) 5 consecutive 1-year breaks in service under defined contribution plan. For purposes of paragraph (4), in the case of any participant in a defined contribution plan, or an insured defined benefit plan which satisfies the requirements of subsection (b)(1)(F), who has 5 consecutive 1-year breaks in service, years of service after such 5-year period shall not be required to be taken into account for purposes of determining the nonforfeitable percentage of his accrued benefit derived from employer contributions which accrued before such 5-year

period.

(D) Nonvested participants.

(i) In general. For purposes of paragraph (4), in the case of a nonvested participant, years of service with the employer or employers maintaining the plan before any period of consecutive 1-year breaks in service shall not be required to be taken into account if the number of consecutive 1-year breaks in service within such period equals or exceeds the greater of--

(I) 5, or

(II) the aggregate number of years of service before such period.

(ii) Years of service not taken into account. If any years of service are not required to be taken into account by reason of a period of breaks in service to which clause (i) applies, such years of service shall not be taken into account in applying clause (i) to a subsequent period of breaks in service.

(iii) Nonvested participant defined. For purposes of clause (i), the term "nonvested participant" means a participant who does not have any nonforfeitable right under the plan to an accrued benefit derived from employer contributions.

(E) Special rule for maternity or paternity absences.

(i) General rule. In the case of each individual who is absent from work for any period--

(I) by reason of the pregnancy of the individual,

(II) by reason of the birth of a child of the individual,

(III) by reason of the placement of a child with the individual in connection with the adoption of such child by such individual, or

(IV) for purposes of caring for such child for a period beginning immediately following such birth or placement, the plan shall treat as hours of service, solely for purposes of determining under this paragraph whether a 1-year break in service has occurred, the hours described in clause (ii).

(ii) Hours treated as hours of service. The hours described in this clause are--

(I) the hours of service which otherwise would normally have been credited to such individual but for such absence, or

(II) in any case in which the plan is unable to determine the hours described in subclause (I), 8 hours of service per day of absence,

except that the total number of hours treated as hours of service under this clause by reason of any such pregnancy or placement shall not exceed 501 hours.

(iii) Year to which hours are credited. The hours described in clause (ii) shall be treated as hours of service as provided in this subparagraph--

(I) only in the year in which the absence from work begins, if a participant would be prevented from incurring a 1-year break in service in such year solely because the period of absence is treated as hours of service as provided in clause (i); or

(II) in any other case, in the immediately following year.

(iv) Year defined. For purposes of this subparagraph, the term "year" means the period used in computations pursuant to paragraph (5).

(v) Information required to be filed. A plan shall not fail to satisfy the requirements of this subparagraph solely because it provides that no credit will be given pursuant to this subparagraph unless the individual furnishes to the plan administrator such timely information as the plan may reasonably require to establish--

(I) that the absence from work is for reasons referred to in clause (i), and

(II) the number of days for which there was such an absence.

(7) Accrued benefit.

(A) In general. For purposes of this section, the term "accrued benefit" means--

§ 416. Special rules for top-heavy plans.

(a) General rule. A trust shall not constitute a qualified trust under section 401(a) for any plan year if the plan of which it is a part is a top-heavy plan for such plan year unless such plan meets--

- (1) the vesting requirements of subsection (b), and*
- (2) the minimum benefit requirements of subsection (c).*

(b) Vesting requirements.

(1) In general. A plan satisfies the requirements of this subsection if it satisfies the requirements of either of the following subparagraphs:

(A) 3-year vesting. A plan satisfies the requirements of this subparagraph if an employee who has completed at least 3 years of service with the employer or employers maintaining the plan has a nonforfeitable right to 100 percent of his accrued benefit derived from employer contributions.

(B) 6-year graded vesting. A plan satisfies the requirements of this subparagraph if an employee has a nonforfeitable right to a percentage of his accrued benefit derived from employer contributions determined under the following table:

The nonforfeitable

Years of service percentage is:

2	20
3	40
4	60
5	80
6 or more	100

(2) Certain rules made applicable. Except to the extent inconsistent with the provisions of this subsection, the rules of section 411 shall apply for purposes of this subsection.

(c) Plan must provide minimum benefits.

(1) Defined benefit plans.

(A) In general. A defined benefit plan meets the requirements of this subsection if the accrued benefit derived from employer contributions of each participant who is a non-key employee, when expressed as an annual retirement benefit, is not less than the applicable percentage of the participant's average compensation for years in the testing period.

(B) Applicable percentage. For purposes of subparagraph (A), the term 'applicable percentage' means *the lesser of--*

(i) 2 percent multiplied by the number of years of service with the employer, or

(ii) 20 percent.

(C) Years of service. For purposes of this paragraph-- * * *

(2) Defined contribution plans.

(A) **In general.** A defined contribution plan meets the requirements of the subsection if the employer contribution for the year for each participant who is a non-key employee *is not less than 3 percent of such participant's compensation*

(within the meaning of section 415). Employer matching contributions (as defined in section 401(m)(4)(A)) shall be taken into account for purposes of this subparagraph (and any reduction under this sentence shall not be taken into account in determining whether section 401(k)(4)(A) applies).

(B) Special rule where maximum contribution less than 3 percent.

(i) In general. The percentage referred to in subparagraph (A) for any year shall not exceed the percentage at which

contributions are made (or required to be made) under the plan for the year for the key employee for whom such percentage is the highest for the year.

(ii) Treatment of aggregation groups.

(I) For purposes of this subparagraph, all defined contribution plans required to be included in an aggregation group under subsection (g)(2)(A)(i) shall be treated as one plan.

(II) This subparagraph shall not apply to any plan required to be included in an aggregation group if such plan enables a defined benefit plan required to be included in such group to meet the requirements of section 401(a)(4) or 410.

(d) Repealed.

(e) Plan must meet requirements without taking into account social security and similar contributions and benefits. A top-heavy plan shall not be treated as meeting the requirement of subsection (b) or (c) unless such plan meets such requirement without taking into account contributions or benefits under chapter 2 (relating to tax on self-employment income), chapter 21 (relating to Federal Insurance Contributions Act), title II of the Social Security Act, or any other Federal or State law.

(f) Coordination where employer has 2 or more plans. * * *

(g) Top-heavy plan defined. For purposes of this section--

(1) In general.

(A) Plans not required to be aggregated. Except as provided in subparagraph (B), the term 'top-heavy plan' means, with respect to any plan year--

(i) any defined benefit plan if, as of the determination date, the present value of the cumulative accrued benefits under the plan

for key employees exceeds 60 percent of the present value of the cumulative accrued benefits under the plan for all employees, and

(ii) *any defined contribution plan if, as of the determination date, the aggregate of the accounts of key employees under the plan exceeds 60 percent of the aggregate of the accounts of all employees under such plan.*

(B) Aggregated plans. * * *

(G) Simple retirement accounts. The term "top-heavy plan" shall **not** include a simple retirement account under section 408(p).

(H) Cash or deferred arrangements using alternative methods of meeting nondiscrimination requirements. The term "top-heavy plan" shall not include a plan which consists solely of--

(i) a cash or deferred arrangement which meets the requirements of section 401(k)(12), and

(ii) matching contributions with respect to which the requirements of section 401(m)(11) are met.

If, but for this subparagraph, a plan would be treated as a top-heavy plan because it is a member of an aggregation group which is a top-heavy group, contributions under the plan may be taken into account in determining whether any other plan in the group meets the requirements of subsection (c)(2).

(h) [Deleted]

(i) Definitions. For purposes of this section--

(1) Key employee.

(A) In general. *The term 'key employee' means an employee who, at any time during the plan year, is--*

(i) an officer of the employer having an annual compensation greater than \$ 130,000,

(ii) a 5-percent owner of the employer, or

(iii) a 1-percent owner of the employer having an annual compensation from the employer of more than \$ 150,000.

For purposes of clause (i), no more than 50 employees (or, if lesser, the greater of 3 or 10 percent of the employees) shall be treated as officers. [In] in the case of plan years beginning after December 31, 2002, the \$ 130,000 amount in clause (i) shall be adjusted at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter beginning July 1, 2001, and any increase under this sentence which is not a multiple of \$ 5,000 shall be rounded to the next lower multiple of \$ 5,000. Such term shall not include any officer or employee of an entity referred to in section 414(d) (relating to governmental plans). For purposes of determining the number of officers taken into account under clause (i), employees described in section 414(q)(5) shall be excluded.

(B) Percentage owners.

(i) 5-percent owner. For purposes of this paragraph, the term '5-percent owner' means--

(I) if the employer is a corporation, any person *who owns* (or is considered as owning within the meaning of section 318) **more than 5 percent** of the outstanding stock of the corporation or stock possessing more than 5 percent of the total combined voting power of all stock of the corporation, or

(II) if the employer is not a corporation, any person who owns

more than 5 percent of the capital or profits interest in the employer.

(ii) 1-percent owner. For purposes of this paragraph, the term '1-percent owner' means any person who would be described in clause (i) if '1 percent' were substituted for '5 percent' each place it appears in clause (i).

(iii) Constructive ownership rules. For purposes of this subparagraph--

(I) subparagraph (C) of section 318(a)(2) shall be applied by substituting '5 percent' for '50 percent', and

(II) in the case of any employer which is not a corporation, ownership in such employer shall be determined in accordance with regulations prescribed by the Secretary which shall be based on principles similar to the principles of section 318 (as modified by subclause (I)).

(C) Aggregation rules do not apply for purposes of determining ownership in the employer. The rules of subsections (b), (c), and (m) of section 414 shall not apply for purposes of determining ownership in the employer.

(D) Compensation. For purposes of this paragraph, the term 'compensation' has the meaning given such term by section 414(q)(4).

(2) Non-key employee. The term 'non-key employee' means any employee who is not a key employee.

(3) Self-employed individuals. In the case of a self-employed individual described in section 401(c)(1)--

(A) such individual shall be treated as an employee, and

(B) such individual's earned income (within the meaning of section 401(c)(2)) shall be treated as compensation.

(4) Treatment of employees covered by collective bargaining agreements. The

(p) Loans treated as distributions. For purposes of this section--

(1) Treatment as distributions.

(A) Loans. If during any taxable year a participant or beneficiary receives (directly or indirectly) any amount as a loan from a qualified employer plan, such amount shall be treated as having been received by such individual as a distribution under such plan.

(B) Assignments or pledges. If during any taxable year a participant or beneficiary assigns (or agrees to assign) or pledges (or agrees to pledge) any portion of his interest in a qualified employer plan, such portion shall be treated as having been received by such individual as a loan from such plan.

(2) Exception for certain loans.

(A) General rule. Paragraph (1) shall not apply to any loan to the extent that such loan (when added to the outstanding balance of all other loans from such plan whether made on, before, or after August 13, 1982), does not exceed the lesser of--

(i) \$ 50,000, reduced by the excess (if any) of--

(I) the highest outstanding balance of loans from the plan during the 1-year period ending on the day before the date on which such loan was made, over

(II) the outstanding balance of loans from the plan on the date on which such loan was made, or

(ii) the greater of (I) one-half of the present value of the nonforfeitable accrued benefit of the employee under the plan, or (II) \$ 10,000.

For purposes of clause (ii), the present value of the nonforfeitable accrued benefit shall be determined without regard to any accumulated deductible employee contributions (as defined in subsection (o)(5)(B)).

(B) Requirement that loan be repayable within 5 years.

(i) In general. Subparagraph (A) shall not apply to any loan unless such loan, by its terms, is required to be repaid within 5 years.

(ii) Exception for home loans. Clause (i) shall not apply to any loan used to acquire any dwelling unit which within a reasonable time is to be used (determined at the time the loan is made) as the principal residence of the participant.

(C) Requirement of level amortization. Except as provided in regulations, this paragraph shall not apply to any loan unless substantially level amortization of such loan (with payments not less frequently than quarterly) is required over the term of the loan.

(D) Related employers and related plans. For purposes of this paragraph--

(i) the rules of subsections (b), (c), and (m) of section 414 shall apply, and

(ii) all plans of an employer (determined after the application of such subsections) shall be treated as 1 plan.

(3) Denial of interest deductions in certain cases.

(A) In general. No deduction otherwise allowable under this chapter shall be allowed under this chapter for any interest paid or accrued on any loan to which paragraph (1) does not apply by reason of paragraph (2) during the period described in subparagraph (B).

(B) Period to which subparagraph (A) applies. For purposes of subparagraph (A), the period described in this subparagraph is the period--

(i) on or after the 1st day on which the individual to whom the loan is made is a key employee (as defined in section 416(i)), or

(ii) such loan is secured by amounts attributable to elective deferrals described in subparagraph (A) or (C) of section 402(g)(3).

(4) Qualified employer plan, etc. For purposes of this subsection--

(A) Qualified employer plan.

(i) In general. The term "qualified employer plan" means--

(I) a plan described in section 401(a) which includes a trust exempt

from tax under section 501(a),

(II) an annuity plan described in section 403(a), and

(III) a plan under which amounts are contributed by an individual's employer for an annuity contract described in section 403(b).

(ii) Special rule. The term "qualified employer plan" shall include any plan which was (or was determined to be) a qualified employer plan or a government plan.

(B) Government plan. The term "government plan" means any plan, whether or not qualified, established and maintained for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing.

(5) Special rules for loans, etc., from certain contracts. For purposes of this subsection, any amount received as a loan under a contract purchased under a qualified employer plan (and any assignment or pledge with respect to such a contract) shall be treated as a loan under such employer plan.

§ 4975. Tax on prohibited transactions.

(a) Initial taxes on disqualified person. There is hereby imposed a tax on each prohibited transaction. The rate of tax shall be equal to 15 percent of the amount involved with respect to the prohibited transaction for each year (or part thereof) in the taxable period. The tax imposed by this subsection shall be paid by any disqualified person who participates in the prohibited transaction (other than a fiduciary acting only as such).

(b) Additional taxes on disqualified person. In any case in which an initial tax is imposed by subsection (a) on a prohibited transaction and the transaction is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of the amount involved. The tax imposed by this subsection shall be paid by any disqualified person who participated in the prohibited transaction (other than a fiduciary acting only as such).

(c) Prohibited transaction.

(1) General rule. For purposes of this section, the term "prohibited transaction" means any direct or indirect--

(A) sale or exchange, or leasing, of any property between a plan and a disqualified person;

(B) lending of money or other extension of credit between a plan and a disqualified person;

(C) furnishing of goods, services, or facilities between a plan and a disqualified person;

(D) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;

(E) act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account; or

(F) receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

(2) Special exemption. The Secretary shall establish an exemption procedure for purposes of this subsection. Pursuant to such procedure, he may grant a conditional or unconditional exemption of any disqualified person or transaction, orders of disqualified persons or transactions, from all or part of the restrictions imposed by paragraph (1) of this subsection. Action under this subparagraph may be taken only after consultation and coordination with the Secretary of Labor. The Secretary may not grant an exemption under this paragraph unless he finds that such exemption is--

(A) administratively feasible,

(B) in the interests of the plan and of its participants and beneficiaries, and

(C) protective of the rights of participants and beneficiaries of the plan.

Before granting an exemption under this paragraph, the Secretary shall require adequate notice to be given to interested persons and shall publish notice in the Federal Register of the pendency of such

exemption and shall afford interested persons an opportunity to present views. No exemption may be granted under this paragraph with respect to a transaction described in subparagraph (E) or (F) of paragraph (1) unless the Secretary affords an opportunity for a hearing and makes a determination on the record with respect to the findings required under subparagraphs (A), (B), and (C) of this paragraph, except that in lieu of such hearing the Secretary may accept any record made by the Secretary of Labor with respect to an application for exemption under section 408(a) of title I of the Employee Retirement Income Security Act of 1974.

(3) Special rule for individual retirement accounts. An individual for whose benefit an individual retirement account is established and his beneficiaries shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if, with respect to such transaction, the account ceases to be an individual retirement account by reason of the application of section 408(e)(2)(A) or if section 408(e)(4) applies to such account.

(4) Special rule for Archer MSAs. An individual for whose benefit an Archer MSA (within the meaning of section 220(d)) is established shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if section 220(e)(2) applies to such transaction.

(5) Special rule for Coverdell education savings accounts. An individual for whose benefit a Coverdell education savings account is established and any contributor to such account shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if section 530(d) applies with respect to such transaction.

(6) Special rule for health savings accounts. An individual for whose benefit a health savings account (within the meaning of section 223(d)) is established shall be exempt from the tax imposed by this section with respect to any transaction concerning such

account (which would otherwise be taxable under this section) if, with respect to such transaction, the account ceases to be a health savings account by reason of the application of section 223(e)(2) to such account.

(d) Exemptions. Except as provided in subsection (f)(6) [*owner-employees of Keogh plans*], the prohibitions provided in subsection (c) shall not apply to--

(1) any loan made by the plan to a disqualified person who is a participant or beneficiary of the plan if such loan-

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(A) is available to all such participants or beneficiaries on a reasonably equivalent basis,

(B) is not made available to highly compensated employees (within the meaning of section 414(q)) in an amount greater than the amount made available to other employees,

(C) is made in accordance with specific provisions regarding such loans set forth in the plan,

(D) bears a reasonable rate of interest, and

(E) is adequately secured;

[#6: Married? Spousal consent for loan 401(a)(11)]

(2) any contract, or reasonable arrangement, made with a disqualified person for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor;

(3) any loan to a leveraged employee stock ownership plan (as defined in subsection (e)(7)), if--

(A) such loan is primarily for the benefit of participants and beneficiaries of the plan, and

(B) such loan is at a reasonable rate of interest, and any collateral

which is given to a disqualified person by the plan consists only of qualifying employer securities (as defined in subsection (e)(8));

(4) the investment of all or part of a plan's assets in deposits which bear a reasonable interest rate in a bank or similar financial institution supervised by the United States or a State, if such bank or other institution is a fiduciary of such plan and if--

(A) the plan covers only employees of such bank or other institution and employees of affiliates of such bank or other institution, or

(B) such investment is expressly authorized by a provision of the plan or by a fiduciary (other than such bank or institution or affiliates thereof) who is expressly empowered by the plan to so instruct the trustee with respect to such investment;

(5) any contract for life insurance, health insurance, or annuities with one or more insurers which are qualified to do business in a State if the plan pays no more than adequate consideration, and if each such insurer or insurers is--

(A) the employer maintaining the plan, or

(B) a disqualified person which is wholly owned (directly or indirectly) by the employer establishing the plan, or by any person which is a disqualified person with respect to the plan, but only if the total premiums and annuity considerations written by such insurers for life insurance, health insurance, or annuities for all plans (and their employers) with respect to which such insurers are disqualified persons (not including premiums or annuity considerations written by the employer maintaining the plan) do not exceed 5 percent of the total premiums and annuity considerations written for all lines of insurance in that year by such insurers (not including premiums or annuity considerations written by the employer maintaining the plan);

(6) the provision of any ancillary service by a bank or similar financial institution supervised by the United States or a State, if

such service is provided at not more than reasonable compensation, if such bank or other institution is a fiduciary of such plan, and if--
(A) such bank or similar financial institution has adopted adequate internal safeguards which assure that the provision of such ancillary service is consistent with sound banking and financial practice, as determined by Federal or State supervisory authority, and

(B) the extent to which such ancillary service is provided is subject to specific guidelines issued by such bank or similar financial institution (as determined by the Secretary after consultation with Federal and State supervisory authority), and under such guidelines the bank or similar financial institution does not provide such ancillary service--

(i) in an excessive or unreasonable manner, and

(ii) in a manner that would be inconsistent with the best interests of participants and beneficiaries of employee benefit plans;

(7) the exercise of a privilege to convert securities, to the extent provided in regulations of the Secretary, but only if the plan receives no less than adequate consideration pursuant to such conversion;

(8) any transaction between a plan and a common or collective trust fund or pooled investment fund maintained by a disqualified person which is a bank or trust company supervised by a State or Federal agency or between a plan and a pooled investment fund of an insurance company qualified to do business in a State if--

(A) the transaction is a sale or purchase of an interest in the fund,

(B) the bank, trust company, or insurance company receives not more than reasonable compensation, and

(C) such transaction is expressly permitted by the instrument under which the plan is maintained, or by a fiduciary (other than the bank, trust company, or insurance company, or an affiliate thereof) who has authority to manage and control the assets of the plan;

(9) receipt by a disqualified person of any benefit to which he may be entitled as a participant or beneficiary in the plan, so long as the benefit is computed and paid on a basis which is consistent with

the terms of the plan as applied to all other participants and beneficiaries;

(10) receipt by a disqualified person of any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan, but no person so serving who already receives full-time pay from an employer or an association of employers, whose employees are participants in the plan or from an employee organization whose members are participants in such plan shall receive compensation from such fund, except for reimbursement of expenses properly and actually incurred;

(11) service by a disqualified person as a fiduciary in addition to being an officer, employee, agent, or other representative of a disqualified person;

(12) the making by a fiduciary of a distribution of the assets of the trust in accordance with the terms of the plan if such assets are distributed in the same manner as provided under section 4044 of title IV of the Employee Retirement Income Security Act of 1974 (relating to allocation of assets);

(13) any transaction which is exempt from section 406 of such Act by reason of section 408(e) of such Act (or which would be so exempt if such section 406 applied to such transaction) or which is exempt from section 406 of such Act by reason of section 408(b)(12) of such Act;

(14) any transaction required or permitted under part 1 of subtitle E of title IV or section 4223 of the Employee Retirement Income Security Act of 1974, but this paragraph shall not apply with respect to the application of subsection (c)(1)(E) or (F); or

(15) a merger of multiemployer plans, or the transfer of assets or liabilities between multiemployer plans, determined by the Pension Benefit Guaranty Corporation to meet the requirements of section 4231 of such Act, but this paragraph shall not apply with respect to the application of subsection (c)(1)(E) or (F).

The exemptions provided by this subsection (other than paragraphs

(9) and (12)) shall not apply to any transaction with respect to a trust described in section 401(a) which is part of a plan providing contributions or benefits for employees some or all of whom are owner-employees (as defined in section 401(c)(3)) in which a plan directly or indirectly lends any part of the corpus or income of the plan to, pays any compensation for personal services rendered to the plan to, or acquires for the plan any property from or sells any property to, any such owner-employee, a member of the family (as defined in section 267(c)(4)) of any such owner-employee, or a corporation controlled by any such owner-employee through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation. For purposes of the preceding sentence, a shareholder-employee (as defined in section 1379, as in effect on the day before the date of the enactment of the Subchapter S Revision Act of 1982), a participant or beneficiary of an individual retirement account or an individual retirement annuity (as defined in section 408), and an employer or association of employees which establishes such an account or annuity under section 408(c) shall be deemed to be an owner-employee.

(e) Definitions.

- (1) Plan. For purposes of this section, the term "plan" means--
- (A) a trust described in section 401(a) which forms a part of a plan, or a plan described in section 403(a), which trust or plan is exempt from tax under section 501(a),
 - (B) an individual retirement account described in section 408(a),
 - (C) an individual retirement annuity described in section 408(b),
 - (D) an Archer MSA described in section 220(d),
 - (E) a health savings account described in section 223(d),
 - (F) a Coverdell education savings account described in section 530, or
 - (G) a trust, plan, account, or annuity which, at any time, has been

determined by the Secretary to be described in any preceding subparagraph of this paragraph.

(2) Disqualified person. For purposes of this section, the term "disqualified person" means a person who is--

(**A) a fiduciary;**

(B) a person providing services to the plan;

(C) an employer any of whose employees are covered by the plan;

(D) an employee organization any of whose members are covered by the plan;

(E) an owner, direct or indirect, of 50 percent or more of--

(i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of a corporation,

(ii) the capital interest or the profits interest of a partnership, or

(iii) the beneficial interest of a trust or unincorporated enterprise, which is an employer or an employee organization described in subparagraph (C) or (D);

(F) a member of the family (as defined in paragraph (6)) of any individual described in subparagraph (A), (B), (C), or (E);

(G) a corporation, partnership, or trust or estate of which (or in which) 50 percent or more of--

(i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of such corporation,

(ii) the capital interest or profits interest of such partnership, or

(iii) the beneficial interest of such trust or estate,

is owned directly or indirectly, or held by persons described in subparagraph (A), (B), (C), (D), or (E);

(H) an officer, director (or an individual having powers or

responsibilities similar to those of officers or directors), a 10

percent or more shareholder, or a highly compensated employee

(earning 10 percent or more of the yearly wages of an employer) of

a person described in subparagraph (C), (D), (E), or (G); or (I) a 10 percent or more (in capital or profits) partner or joint venturer of a person described in subparagraph (C), (D), (E), or (G).

The Secretary, after consultation and coordination with the Secretary of Labor or his delegate, may by regulation prescribe a percentage lower than 50 percent for subparagraphs (E) and (G) and lower than 10 percent for subparagraphs (H) and (I).

(3) Fiduciary. For purposes of this section, the term "fiduciary" means any person who--

(A) *exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets,*

(B) *renders investment advice for a fee or other compensation,* direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or

(C) *has any discretionary authority or discretionary responsibility in the administration of such plan.*

Such term includes any person designated under section 405(c)(1)(B) of the Employee Retirement Income Security Act of 1974.

(4) Stockholdings. For purposes of paragraphs (2)(E)(i) and (G)(i) there shall be taken into account indirect stockholdings which would be taken into account under section 267(c), except that, for purposes of this paragraph, section 267(c)(4) shall be treated as providing that the members of the family of an individual are the members within the meaning of paragraph (6).

(5) Partnerships; trusts. For purposes of paragraphs (2)(E)(ii) and

(iii), (G)(ii) and (iii), and (I) the ownership of profits or beneficial interests shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c) (other than paragraph (3) thereof), except that section 267(c)(4) shall be treated as providing that the members of the family of an individual are the members within the meaning of paragraph (6).

(6) Member of family. For purposes of paragraph (2)(F), the family of any individual shall include his spouse, ancestor, lineal descendant, and any spouse of a lineal descendant.

(7) Employee stock ownership plan. The term "employee stock ownership plan" means a defined contribution plan--

(A) which is a stock bonus plan which is qualified, or a stock bonus and a money purchase plan both of which are qualified under section 401(a), and which are designed to invest primarily in qualifying employer securities; and

(B) which is otherwise defined in regulations prescribed by the Secretary.

A plan shall not be treated as an employee stock ownership plan unless it meets the requirements of section 409(h), section 409(o), and, if applicable, section 409(n), 409(p), and section 664(g) and, if the employer has a registration-type class of securities (as defined in section 409(e)(4)), it meets the requirements of section 409(e).

(8) Qualifying employer security. The term "qualifying employer security" means any employer security within the meaning of section 409(1).

If any moneys or other property of a plan are invested in shares of an investment company registered under the Investment Company Act of 1940, the investment shall not cause that investment company or that investment company's investment adviser or principal underwriter to be treated as a fiduciary or a disqualified person for purposes of this section, except when an investment company or its investment adviser or principal underwriter acts in connection with a plan covering employees of the investment company, its investment adviser, or its principal underwriter.

(9) Section made applicable to withdrawal liability payment funds. For purposes of this section--

(A) In general. The term "plan" includes a trust described in section 501(c)(22).

(B) Disqualified person. In the case of any trust to which this section applies by reason of subparagraph (A), the term "disqualified person" includes any person who is a disqualified person with respect to any plan to which such trust is permitted to make payments under section 4223 of the Employee Retirement Income Security Act of 1974.

(f) Other definitions and special rules. For purposes of this section--

(1) Joint and several liability. If more than one person is liable under subsection (a) or (b) with respect to any one prohibited transaction, all such persons shall be jointly and severally liable under such subsection with respect to such transaction.

(2) Taxable period. The term "taxable period" means, with respect to any prohibited transaction, the period beginning with the date on which the prohibited transaction occurs and ending on the earliest of--

(A) the date of mailing a notice of deficiency with respect to the tax imposed by subsection (a) under section 6212,

(B) the date on which the tax imposed by subsection (a) is assessed, or

(C) the date on which correction of the prohibited transaction is completed.

(3) Sale or exchange; encumbered property. A transfer of real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer.

(4) Amount involved. The term "amount involved" means, with respect to a prohibited transaction, the **greater of the amount of**

money and the fair market value of the other property given or the amount of money and the fair market value of the other property received; except that, in the case of services described in paragraphs (2) and (10) of subsection (d) the amount involved shall be only the excess compensation. For purposes of the preceding sentence, the fair market value--

(A) in the case of the tax imposed by subsection (a), shall be determined as of the date on which the prohibited transaction occurs; and

(B) in the case of the tax imposed by subsection (b), shall be the highest fair market value during the taxable period.

(5) *Correction.* The terms "correction" and "correct" mean, with respect to a prohibited transaction, undoing the transaction to the extent possible, but in any case placing the plan in a financial position not worse than that in which it would be if the disqualified person were acting under the highest fiduciary standards.

(6) *Exemptions not to apply to certain transactions.*

(A) In general. In the case of a trust described in section 401(a) which is part of a plan providing contributions or benefits for employees some or all of whom are **owner-employees** (as defined in section 401(c)(3)), the exemptions provided by subsection (d) (other than paragraphs (9) and (12)) shall not apply to a transaction in which the plan directly or indirectly--

(i) lends any part of the corpus or income of the plan to,

(ii) pays any compensation for personal services rendered to the plan to, or

(iii) acquires for the plan any property from, or sells any property to,

any such owner-employee, a member of the family (as defined in section 267(c)(4)) of any such owner-employee, or any corporation in which any such owner-employee owns, directly or indirectly, 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of

shares of all classes of stock of the corporation.

(B) Special rules for *shareholder-employees*, etc.

(i) In general. For purposes of subparagraph (A), ***the following shall be treated as owner-employees:***

(I) A shareholder-employee.

(II) A participant or beneficiary of an individual retirement plan (as defined in section 7701(a)(37)).

(III) An employer or association of employees which establishes such an individual retirement plan under section 408(c).

(ii) Exception for certain transactions involving shareholder-employees. Subparagraph (A)(iii) shall not apply to a transaction which consists of a sale of employer securities to an employee stock ownership plan (as defined in subsection (e)(7)) by a shareholder-employee, a member of the family (as defined in section 267(c)(4)) of such shareholder-employee, or a corporation in which such a shareholder-employee owns stock representing a 50 percent or greater interest described in subparagraph (A).

(iii) Loan exception. For purposes of subparagraph (A)(i), the term "owner-employee" shall only include a person described in subclause (II) or (III) of clause (i).

(C) Shareholder-employee. For purposes of subparagraph (B), the term "shareholder-employee" means an employee or officer of an S corporation who owns (or is considered as owning within the meaning of section 318(a)(1)) more than 5 percent of the outstanding stock of the corporation on any day during the taxable year of such corporation.

(g) Application of section. This section shall not apply--

(1) in the case of a plan to which a guaranteed benefit policy (as defined in section 401(b)(2)(B) of the Employee Retirement Income Security Act of 1974) is issued, to any assets of the insurance company, insurance service, or insurance organization merely because of its issuance of such policy;

(2) to a governmental plan (within the meaning of section 414(d));

or

(3) to a church plan (within the meaning of section 414(e)) with respect to which the election provided by section 410(d) has not been made.

In the case of a plan which invests in any security issued by an investment company registered under the Investment Company Act of 1940, the assets of such plan shall be deemed to include such security but shall not, by reason of such investment, be deemed to include any assets of such company.

(h) Notification of Secretary of Labor. Before sending a notice of deficiency with respect to the tax imposed by subsection (a) or (b), the Secretary shall notify the Secretary of Labor and provide him a reasonable opportunity to obtain a correction of the prohibited transaction or to comment on the imposition of such tax.

(i) Cross reference. For provisions concerning coordination procedures between Secretary of Labor and Secretary of the Treasury with respect to application of tax imposed by this section and for authority to waive imposition of the tax imposed by subsection (b), see section 3003 of the Employee Retirement Income Security Act of 1974.