

MANUAL TRANSMITTAL

Department
of the
Treasury

Internal
Revenue
Service

4.72.15

JUNE 14, 2002

PURPOSE

This transmits new text and exhibits for IRM 4.72.15, Employee Plans Technical Guidance, Internal Revenue Code (IRC) 404 Examination Guidelines.

BACKGROUND

This IRM provides guidelines for examining the deductibility of contributions by sponsoring employers of a qualified retirement plan subject to the limits of section 404 of the IRC.

NATURE OF CHANGES

These procedures are new.

INTENDED AUDIENCE

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4.72.15.1 (06-14-2002)

Overview

- (1) NOTE: This chapter does not address changes applicable to IRC 404 under the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107-16 (EGTRRA).
- (2) These guidelines provide guidance on examining the deductibility of contributions by sponsoring employers of a qualified retirement plan subject to the limits of section 404 of the Internal Revenue Code (IRC).
- (3) These guidelines are not intended to be all-inclusive; consequently, the techniques identified may be modified based on the actual examination issues encountered. The purpose of these guidelines is to help the examining specialist decide what areas to concentrate on and what issues to raise with respect to particular plans. Given the purpose of these guidelines, they cannot be, nor are they intended to be, a precedential or comprehensive statement of the Service's legal position on the issues covered herein. They are not to be relied upon or cited as authority to taxpayers. Accordingly, the guidelines are being issued for the sole purpose of assisting the examining specialist in performing an examination of certain issues for which it was believed guidelines would be helpful. It is not expected that each issue discussed in these guidelines will be relevant in every examination.

4.72.15.2 (06-14-2002)

**Deductions -
General Rules
and
Applicability**

- (1) Contributions to qualified plans are deductible by the sponsoring employer (subject to the limits of IRC 404) and the plan beneficiaries are not taxed until benefits are received.
- (2) The amount deductible under IRC 404 must first be deductible under Chapter 1 of the Internal Revenue Code (generally, under IRC 162 as an ordinary and necessary business expense). The deduction must be based on compensation paid or accrued for services actually rendered; payment for future services is not to be included.
 - a. Under a special rule for self-employed individuals, contributions to the plan on behalf of an employee are considered to satisfy the conditions of IRC 162 or IRC 212 to the extent that they do not exceed the individual's earned income (determined without regard to the deductions allowed by this section) derived from the trade or business with respect to which such plan is established, and to the extent that such contributions are not allocable to the purchase of life, accident, health, or other insurance (i.e., if the plan deduction does not exceed the individual's earned income from the business sponsoring the plan determined before the plan deduction). See IRC 404(a)(8).
- (3) Contributions must actually be "paid" to the plan. See *Rollar Homes, Inc. v. Comm.*, T.C. Memo. 1987-166.
- (4) The plan must be written, communicated to employees, and in effect by year end. See *Engineered Timber Sales, Inc. v. Comm.*, 74 TC 808 (1980).

- (5) IRC 404 also provides for the deductibility of contributions for non-qualified plans of deferred compensation or benefits; the employer receives a deduction at the same time participants include the value of benefits as taxable income.
- a. However, if separate accounts are not maintained, there is no employer deduction, even when employees are taxed on the benefits. See IRC 404(a)(5) and Rev. Rul. 88-68.
 - b. The deduction for amounts credited as “interest” to employee accounts must be postponed until the tax year when such amounts are includible in employee income. See *Albertson’s Inc. v. Commissioner*, 94-2 USTC (9th Circuit 1994). Also, see Notice 94-38.

4.72.15.2.1 (06-14-2002)

**General Rules
for Defined
Benefit Plans**

- (1) In the case of a defined benefit plan, an actuarial valuation is performed by an actuary to determine benefits, liabilities, minimum funding requirements, and the maximum tax deductible contribution, among other things.
- a. The maximum deduction is based in part on the benefits provided by the plan, and the assumptions employed by the actuary as to interest, mortality, turnover, etc.

4.72.15.2.1.1 (06-14-2002)

**General
Deductible Limit
Under IRC 404**

- (1) In general, the maximum deduction under IRC 404 is given by one of the three rules found under IRC 404(a)(1)(A)(i), (ii), and (iii).

4.72.15.2.1.1.1 (06-14-2002)

**IRC
404(a)(1)(A)(i):
Minimum
Funding
Requirement**

- (1) Under IRC 404(a)(1)(A)(i), a deduction is provided for the minimum required under IRC 412 to avoid a funding deficiency. Under this rule, the employer can deduct what is required to fund the plan for IRC 412 minimum funding standards.
- (2) A special rule under Reg. 1.404(a)-14(e)(1)(ii) provides if amounts required under IRC 412 were paid for the preceding year but were not deducted solely because they were not timely paid for IRC 404, they are “includible contributions” and are deductible under the IRC 404(a)(1)(A)(i) rule for the current year. Note, however, that total deductions under IRC 404(a)(1)(A)(i) are subject to the applicable full funding limit.
- (3) Example 1:
- Plan Year End = Fiscal Year End = Calendar Year; Tax Return due & filed 3/15 of following year.
 - Required Under IRC 412 for 1996: \$10,000
Required Under IRC 412 for 1997: \$11,000
 - Paid 3/15 following year & deducted previous year: 1996 - \$8,000;
1997 - \$11,000
 - Paid 9/15 following yr: 1996 - \$2,000; 1997 - \$0

- “Includible Contributions”: 1996 - \$0; 1997 - \$2,000
- Total Deduction: 1996 - \$8,000; 1997 - \$13,000
- Total Paid: 1996 - \$10,000; 1997 - \$11,000

For the 1996 year, the employer timely paid \$10,000 within 8½ months for IRC 412 purposes (\$8,000 on 3/15/97, and \$2,000 on 9/15/97). However, only \$8,000 was deductible for 1996 because \$2,000 was not timely paid for IRC 404 purposes (it was paid subsequent to the tax return filing on 3/15/97). Assuming that the full funding limitation does not otherwise limit the deduction, this \$2,000 is deductible as an “includible contribution” in 1997, even though when added to the \$11,000 contribution for 1997 it causes the deduction to exceed the otherwise computed IRC 404(a)(1)(A)(i) limit.

4.72.15.2.1.1.2 (06-14-2002) (1)
**404(a)(1)(A)(ii):
 Level Spread
 Method**

Under IRC 404(a)(1)(A)(ii), a deduction is provided for the level funding amount. Under this rule, the employer can deduct the cost of funding all benefits, as a level dollar amount or a level percent of pay, over the future service of employees.

- a. This rule applies to certain actuarial cost methods that allocate or spread the cost of unfunded benefits over future service.
- b. If the cost with respect to any three (3) participants exceeds 50% of the total cost, the cost for such participants must be spread over at least 5 taxable years.

4.72.15.2.1.1.3 (06-14-2002) (1)
**404(a)(1)(A)(iii):
 Normal Cost
 Plus 10 Year
 Amortization**

Under IRC 404(a)(1)(A)(iii), a deduction is provided for the normal cost plus 10 year unfunded liability amortization. Under this rule, an employer can deduct the normal cost computed by the actuarial funding method, plus a level 10 year amortization of unfunded liabilities.

- a. This rule is applicable to certain actuarial cost methods that separately identify liability attributable to past events.

(2) An equation can be written as:
 404(a)(1)(A)(iii) Limit = (NC + sum of limit adjustments + interest), where

- “NC” is the normal cost for the plan year;
- “limit adjustment” is the lesser of the 10 year amortization amounts or the outstanding balance of the liability bases; and
- “interest” is interest to the earlier of the end of the plan year or fiscal year. See 4.72.15.2.1.4.1, for rules on establishing amortization bases.

4.72.15.2.1.2 (06-14-2002) (1)
**Consistent
 Treatment: IRC
 404 to IRC 412**

Under Reg. 1.404(a)-14(d)(1), the computation of the deductible limit for a plan year is based on the benefit structure used for purposes of IRC 412 for the plan year.

- (2) In general, the assumptions, methods, and factors used in computing costs for IRC 412 minimum funding standards must also be used for computing IRC 404 deductible limits.
- (3) There are exceptions to this, however:
 - a. As discussed below, the assets used for IRC 404 maximum deduction purposes may differ from the assets used in IRC 412 minimum funding computations.
 - b. As discussed above, IRC 404(a)(1)(A)(ii) requires spreading the cost for certain participants over a minimum of five (5) years in some situations. There is no similar requirement under the IRC 412 rules.
 - c. When the Alternative Minimum Funding Standard is used under IRC 412, the amount deductible under IRC 404(a)(1)(A)(i) as the amount needed to avoid a funding deficiency will be different than the amount required under the alternative standard to avoid a deficiency on the Schedule B. Alternative Minimum Funding Standards are encountered infrequently in practice. See Reg. 1.404(a)-14(e)(2).

4.72.15.2.1.3 (06-14-2002)
**Linking Tax Year
 to Plan Year**

- (1) The employer's deduction is taken for a tax year, but is determined with reference to a plan year.
 - a. When the two years are the same, the concurrent plan year controls the tax year deduction.
 - b. Reg. 1.404(a)-14(c) provides that, if the two years do not coincide, the deductible limit is determined from either the plan year that begins in the tax year, the plan year that ends in the tax year, or a pro-rata share of each year.
 - c. The linkage that is chosen by the employer cannot be changed unless approved as a change in accounting method under IRC 446(e).

Note: Once the Schedule B, Form 5500 is filed, it is generally determinative regarding the minimum funding requirement. See *Rubin v. Commissioner*, Tax Court, 103 T.C. No. 13, August 15, 1994.

4.72.15.2.1.4 (06-14-2002)
**Amortization
 Bases**

- (1) If the deductible limit is determined under IRC 404(a)(1)(A)(iii), the maximum deduction consists of the normal cost of the plan, plus the limit adjustments for the 10-year amortization bases, plus interest to the earlier of the plan year end or the fiscal year end. The limit adjustments require the maintenance of amortization bases.

4.72.15.2.1.4.1 (06-14-2002)
**Establishing
 Amortization
 Bases**

- (1) Reg. 1.404(a)-14(g) provides for the establishment of 10-year amortization bases for purposes of determining the deductible limit under IRC 404(a)(1)(A)(iii).
- (2) In general, for an immediate gain funding method, a 10-year base must be established each time a separate amortization base is established for purposes of IRC 412 for one of the following:

- a. experience gains or losses;
 - b. change in actuarial assumptions;
 - c. change in funding method; or
 - d. past service based upon establishment or amendment of the plan.
- (3) A spread gain method must not establish a base for a gain or loss but rather must spread that amount in future normal costs. See Reg. 1.404(a)-14(g).
- a. If a plan using such a method is required under IRC 412(b)(2)(B)(v) or IRC 412(b)(3)(B)(iii) to create an amortization base, it must establish a 10-year base for a change in actuarial assumptions. In general, if the creation of an amortization base is required under the rules of IRC 412(b)(2)(B)(ii) or (iii) or IRC 412(b)(3)(B)(i), then a 10-year base must be established when a plan is established or amended.
 - b. If a change in funding method results in an increase or decrease in an unfunded liability required to be amortized under IRC 412, then a 10-year base must be established equal to the increase or decrease in unfunded liability resulting from the change in funding method.
- (4) A 10-year base is not established for a waived funding deficiency or for the base that is established when switching back to the regular funding standard account from the alternate funding standard account.
- (5) Also, no IRC 404 base is established for the IRC 412 base established for current liability full funding.

4.72.15.2.1.4.2 (06-14-2002)

**Limit
Adjustment**

- (1) The limit adjustment for any 10-year amortization base is the lesser of the level amount necessary to amortize the base over 10 years using the valuation rate, or the outstanding amount of the base.

4.72.15.2.1.4.3 (06-14-2002)

**Amortization
Base
Maintenance**

- (1) Reg. 1.404(a)-14(h) provides for the maintenance of 10-year amortization bases. Reg. 1.404(a)-14(h)(3) specifically sets out the procedure for determining the unamortized amount of a base.
- (2) It is necessary to maintain the unamortized portion of the base in order to know when a base has been fully amortized.
- (3) After a base has been fully amortized, the employer can no longer include the limit adjustment for base in determining the deductible limit.
- (4) Therefore, if no base has been in existence for more than 10 years, no adjustments will result from any failure to correctly maintain unamortized amounts.
- (5) If bases are in existence, a fresh start base may be established in accordance with Reg. 1.404(a)-14(i)(5).

- 4.72.15.2.1.4.4 (06-14-2002) (1) Under a reasonable funding method, the sum of all the outstanding IRC 404 bases should equal the unfunded liability of the plan taking into account the assets adjusted as described below. If this is not the case, ask the actuary to explain any discrepancy.
- Balance Equation**
- 4.72.15.2.1.4.5 (06-14-2002) (1) Reg. 1.404(a)-14(i) provides for the combining and/or offsetting of existing 10-year bases into a single 10-year base. This procedure differs from that used for combining and offsetting amortization bases for purposes of IRC 412.
- Combining and Offsetting Bases**
- 4.72.15.2.1.4.6 (06-14-2002) (1) Reg. 1.404(a)-14(i)(5) allows a fresh start alternative whereby all existing bases are replaced with one new 10-year base equal to the unfunded liability of the plan. (Note that the unfunded liability must consider the assets, adjusted as described below).
- Fresh Start Alternative**
- 4.72.15.2.1.5 (06-14-2002) (1) Under Reg. 1.404(a)-14(d)(2), certain adjustments must be made to both the actuarial value of the plan's assets and the market value of the plan's assets. These adjustments are made for purposes of determining the deductible limit under IRC 404(a)(1)(A).
- Asset Adjustments**
- a. The adjustments are used when computing the IRC 404 normal cost with aggregate type funding methods (e.g., the individual aggregate funding method), computing unfunded liabilities, and computing the full funding limitation described in Reg. 1.404(a)-14(k).
 - b. There must be subtracted from the assets the amount of any plan contribution for a plan year in which the plan was qualified that has not been previously deducted (even if that amount may have been credited to the funding standard account). In the case of a plan using a spread gain funding method which maintains an unfunded liability (e.g., the frozen initial liability method, but not the aggregate method), such amount must be included in the unfunded liability of the plan. See Reg. 1.404(a)-14(d)(2)(i).
 - c. There must be included in the assets the amount of any plan contribution for a plan year that has been deducted with respect to a prior plan year (even if that amount is considered under IRC 412 to be contributed in a plan year subsequent to that prior plan year). In the case of a plan using a spread gain funding method which does not maintain an unfunded liability, such amount must be excluded from the unfunded liability of the plan. See Reg. 1.404(a)-14(d)(2)(ii).
- 4.72.15.3 (06-14-2002) (1) While the general limitations on deductions are provided under IRC 404(a)(1)(A)(i),(ii), and (iii), exceptions to the general rules may result in a greater or lesser amount being deductible.
- Additional Rules and Exceptions**

4.72.15.3.1 (06-14-2002)
Benefits To Be Valued

- (1) In valuing the plan, the actuary may be constrained in the amount of benefits to value.
- (2) Changes in plan benefits that become effective in a future year are to be ignored. See Reg. 1.412(c)(3)-1(d)(1) and Rev. Rul. 77-2.
- (3) Also, under Reg. 1.415-5, automatic increases in the IRC 415 dollar limitation do not apply until January 1 of the calendar year in which they become effective.
 - a. TEFRA reinforced this position by adding IRC 404(j). This section states the computation of the deductible limit shall not include any benefits in excess of the IRC 415 limit for such year.
 - b. Also see United States Tax Court Case 80 T.C. No. 4, Feichtinger v. Commissioner, which upheld this position for years prior to TEFRA.
 - c. Should a plan contain no provision for increasing the dollar limitation, the benefits are always limited to the dollar limit specified in the plan. See Rev. Ruls. 81-195 and 81-215 for illustration of the application of these rules.
- (4) Therefore, the funding method may not take into account either of the increases discussed in (2) and (3) above when computing the deductible limits under IRC 404(a)(1)(A).

4.72.15.3.2 (06-14-2002)
Compensation Limitations

- (1) The compensation limitation of IRC 401(a)(17) applies in determining the deductible limit.
 - a. For years after 1993, compensation in excess of \$150,000 cannot be taken into account. The \$150,000 limit is subject to future increases. For example, the limitation was \$160,000 for 1999, and \$170,000 for 2000 and 2001.
 - b. For years before 1997, the family aggregation rules of IRC 414(q)(6) apply. Thus, the combined compensation of spouses and their children under age 19 cannot exceed the 401(a)(17) compensation limit (as adjusted). For years after 1996, this family aggregation rule no longer applies.

4.72.15.3.3 (06-14-2002)
Full Funding Limitations and IRC 404

- (1) The amount computed under the general IRC 404 rules above is limited by the full funding limitation.
 - a. IRC 404(a)(1)(A) provides that the maximum amount deductible for a taxable year shall be an amount equal to the full funding limitation for such year determined under IRC 412. See also Reg. 1.404(a)-14(k).
 - b. In determining the applicable full funding limitation for IRC 404 purposes, assets must be adjusted as required for other IRC 404 purposes. See Reg. 1.404(a)-14(k). See also IRC 412 chapter on "Full Funding Limitation" (section 4.72.16.4.6), for further rules and discussion.
 - c. Where the prevailing FFL is the accrued liability FFL, and the total deductible contribution (including carryovers) for a plan year equals

or exceeds such accrued liability FFL (and the amount of the accrued liability FFL is contributed), then all 10 year amortization bases maintained by the plan will be considered fully amortized and the deductible limit for subsequent plan years will not be adjusted to reflect the amortization of these bases.

- d. Where the prevailing FFL is the 150% current liability FFL and the total deductible contribution (including carryovers) equals or exceeds such FFL, the IRC 404 bases continue to be amortized with the deductible contribution.

4.72.15.3.4 (06-14-2002)

**Other
Limitations**

- (1) An amount greater than the above limits may be deductible under the exceptions of IRC 404(a)(1)(D) or IRC 404(g).

4.72.15.3.4.1 (06-14-2002)

**Special Limit
For Large Plans**

- (1) IRC 404(a)(1)(D) provides a special rule for certain non-multiemployer defined benefit plans.
- (2) The plan must have 101 or more participants (including former participants or beneficiaries with assets still held by the plan) for the plan year.
- a. The 101 or more participant's rule counts all employees of the employer in all defined benefit plans maintained by the employer.
- (3) For such plans, the maximum amount deductible under IRC 404(a)(1) shall not be less than the unfunded current liability determined under IRC 412(l) for the plan year.
- a. The unfunded current liability includes adjustment to the end of the earlier of the tax year or the plan year for benefits accruing during the year plus interest to the same date at current liability interest rate.

4.72.15.3.4.2 (06-14-2002)

**Terminating
Plans: IRC
404(g)**

- (1) IRC 404(g) provides special rules concerning the deduction of employer liability payments paid under section 4041(b), section 4062, section 4063, section 4064, or part 1 of Subtitle E of Title IV of ERISA.
- (2) No deduction is allowable under IRC 404(g) to provide for benefits in excess of guaranteed benefits. Thus, an employer cannot immediately deduct the difference between the present value of accrued benefits and the assets even if the plan is terminating.
- (3) Amounts contributed in the year of termination, but not fully deductible, are subject to deduction rules under IRC 404(a) in subsequent years.
- (4) Amounts deductible under IRC 404(g) are subject to the full funding limit.
- (5) (1) through (4) above are applicable to qualified plans only. See Reg. 1.404(g)-1(c)(2).

4.72.15.3.4.3 (06-14-2002)

**Collectively
Bargained
Plans: IRC
404(a)(1)(B) and
(C)**

- (1) A special rule applies for collectively bargained plans. If an amendment decreases benefits, and the full funding limit for the year is zero, a deduction is allowed equal to the lesser of a or b below:
 - a. the full funding limit plus the unamortized base resulting from the decrease in benefit liability due to the amendment; or
 - b. the normal cost minus a 10 year amortization of the benefit liability decrease.
- (2) Further, a collectively bargained plan maintained by a regulated utility doing business in at least 40 states may treat a decrease in liability due to increases in Social Security benefits as a plan amendment for purposes of this rule.

4.72.15.3.5 (06-14-2002)

Interest

- (1) Under IRC 404(a)(1)(A)(ii) and (iii), the deductible limit may include interest on the actuarially computed costs. Such interest is computed from the date the costs are determined to the earlier of (i) the end of the plan year; or (ii) the end of the fiscal/tax year. See Reg. 1.404(a)-14(f)(3).

Example: For a plan with a calendar year plan year, a level cost under IRC 404(a)(1)(A)(ii) is computed as \$10,000 as of January 1, 1996. The fiscal year that relates to the plan year ends June 30, 1996. The interest rate used is 8%. The maximum deductible limit under IRC 404(a)(1)(A)(ii) is \$10,400; which is the \$10,000 level cost plus one-half year's interest to June 30, since this ends earlier than the plan year.

4.72.15.3.6 (06-14-2002)

**Expenses &
Fees**

- (1) Administrative fees and expenses paid directly by the employer are deductible to the employer under IRC 162 or IRC 212.
- (2) Such expenses are not considered plan contributions and, hence, are not subject to the limits of IRC 404. See Rev. Rul. 84-146.
- (3) However, investment fees, brokers' commissions and the like paid by the plan sponsor are treated as plan contributions subject to the limits of IRC 404. See Rev. Rul. 86-142.

4.72.15.3.7 (06-14-2002)

**Uniform
Capitalization
Rules**

- (1) Employers subject to the uniform capitalization rules may not be able to deduct the full IRC 404 limit.
- (2) A portion of the 404 limit may be required to be assigned to production or inventory costs, which are capitalized and not immediately deductible. See Announcement 88-55.

4.72.15.3.8 (06-14-2002)

**Time of
Payment**

- (1) For purposes of IRC 404(a)(1), (2), and (3), contributions paid up until the due date of the taxpayer's tax return (including extensions) may be deemed to be paid on the last day of the preceding tax year provided that such contributions are on account of the preceding tax year. However,

see Rev. Rul. 90-105 for clarification of the application of IRC 404(a)(6) relating to 401(k) plans and matching contributions. Also, see *Flomac Inc. v. Commissioner*, T.C. Memo. 1987-122 regarding the timeliness of contributions for deduction purposes.

4.72.15.3.9 (06-14-2002)

**In-Kind
Contributions**

- (1) While contributions to qualified plans in a form other than cash are technically allowed, such contributions bear special scrutiny. When examining a plan, consider the following tips. See also Prohibited Transactions Examination Guidelines (IRM 4.72.11).
- a. Check the Form 5500 for indications of non-cash contributions.
 - b. Verify the fair market value of any property contributed.
 - c. Confirm that the deduction claimed with respect to the property does not exceed IRC 404 limits.
 - d. Determine if the property was contributed to satisfy a funding obligation. If so, this is a prohibited transaction. See also *Comm. v. Keystone Consolidated Industries*, 568 U.S. 152 (1993).
 - e. See if any liens were attached to the property contributed. If so, this is a prohibited transaction. An employer's contribution of a promissory note is not adequate payment for IRC 404, and is a prohibited transaction. See the 7th Circuit Appellate Ct. decision in *Don E. Williams Co. v. Commissioner*, as well as Rev. Rul. 80-140.

4.72.15.3.10 (06-14-2002)

**Money
Purchase Plans**

- (1) The deductible limit is usually determined under IRC 404(a)(1)(A)(i) as the amount needed to satisfy the minimum funding standard, unless a larger amount is required because of a prior funding waiver.
- (2) The maximum deduction is determined based on IRC 415 limits.

4.72.15.3.11 (06-14-2002)

**Profit Sharing
Plans**

- (1) The deductible limit is determined under IRC 404(a)(3) as the greater of 15% of the compensation paid during the taxable year to the participants, or the amount an employer is required to contribute under IRC 401(k)(11).

4.72.15.3.12 (06-14-2002)

**Combined
Limits Under
IRC 404(a)(7)**

- (1) If amounts are deductible under IRC 404(a)(1) through (4) in connection with one or more defined contribution plans and one or more defined benefit plans, (e.g., a defined contribution plan and a profit sharing plan, or a profit sharing plan and a defined benefit plan), the total amount deductible in a taxable year under such plans must not exceed the greater of:
- a. 25% of the compensation paid (or accrued) during the taxable year to the beneficiaries under such plans, or
 - b. The amount of contributions made to or under the defined benefit plans to the extent such contributions do not exceed the amount of employer contributions necessary to satisfy the IRC 412 minimum

funding standard with respect to such defined benefit plans for the plan year which ends with or within the taxable year (or for any prior plan year).

- (2) In the case of any defined benefit plan (other than a multiemployer plan) with over 100 participants for the plan year, the amount necessary to satisfy the minimum funding standard with respect to such plan year for purposes of (1) above shall not be less than the unfunded current liability of the plan under IRC 412(l).
- (3) The two or more plan limits apply using the minimum funding standards for the plan year ending with or within the tax year. This could be different than the applicable deductible limit if the employer usually determined the deductible limit based on the plan year commencing in the tax year.
- (4) If the IRC 404(a)(7) limit restricts an employer from making deductible contributions to a defined contribution plan, the plan will not be considered as failing to provide definitely determinable benefits. Of course, the plan must have language limiting the employer contributions.

4.72.15.3.13 (06-14-2002)

Allocation of Deduction for Multiemployer Collectively Bargained Plans Described in IRC 413(b)

- (1) IRC 413(b)(7) provides that each applicable limitation provided by IRC 404(a) is determined as if all participants in a collectively bargained plan are employed by a single employer. See the proposed chapter on Multiemployer Plans for further rules and discussion.
- (2) The amounts contributed to the plan by a participating employer, for the portion of the taxable year which is included in the plan year, are considered not to exceed a limitation of IRC 404(a) if the anticipated employer contributions for such plan year do not exceed such limitation.
 - a. For this purpose, anticipated employer contributions are determined in a manner consistent with the manner in which actual contributions are determined.
- (3) If such anticipated contributions exceed the IRC 404(a) limitation, the portion of each such employer's contributions which is not deductible under IRC 404 shall be determined in accordance with regulations prescribed by the Secretary.
- (4) Trustees of multiemployer plans under which the contributions may exceed the IRC 404 limits often correct the problem by adopting amendments increasing benefits. If the amendment is to have retroactive effect, however, it must satisfy the requirements of IRC 412(c)(8).

4.72.15.3.14 (06-14-2002)

Multiple Employer Plans Described in IRC 413(c)

- (1) If the plan was established as a multiple employer plan after December 31, 1988, limitations under IRC 404(a) are determined as if each employer were maintaining a separate plan. For purposes of computing these limitations, assets and liabilities are allocated in accordance with IRC 413(c)(7).

- (2) If the plan was established on or before December 31, 1988, and if a timely election was not made (within the first plan year beginning after the enactment of the Technical and Miscellaneous Revenue Act of 1988) to use the rules under (1) above, deductions are determined under 4.72.15.3.13, Allocation of Deduction for Multiemployer Collectively Bargained Plans Described in IRC 413(b). See Announcement 90-3.

4.72.15.4 (06-14-2002)

**Excise Tax on
Nondeductible
Contributions**

- (1) IRC 4972 imposes an excise tax on employers (other than governmental and certain tax-exempt employers) equal to 10% of the nondeductible contributions made to a qualified employer plan.
 - a. A qualified employer plan generally means any plan meeting the requirements of IRC 401(a) that includes a trust exempt from tax under IRC 501(a), any annuity plan described in IRC 403(a), any simplified employee pension within the meaning of IRC 408(k), and any simple retirement account (within the meaning of IRC 408(p).
 - b. For a tax-exempt employer to be exempt from the tax imposed by IRC 4972, the employer must have at all times been exempt from tax under subtitle A of the Internal Revenue Code and not have received any tax benefit from the plan.
- (2) When paying the tax imposed under IRC 4972, the appropriate form to file is Form 5330.
- (3) IRC 4972(c)(6)(B), added by RPA '94, provides a limited exception to this excise tax. Under IRC 4972(c)(6)(B), the excise tax does not apply to contributions to defined contribution plans that are nondeductible solely because of the IRC 404(a)(7) combined limit on deductions for contributions.
 - a. The IRC 4972(c)(6)(B) exception to the excise tax applies only to the extent that nondeductible contributions do not exceed six percent of compensation paid or accrued to beneficiaries under the defined contribution plans, and only if IRC 404(a)(1)(D) applies to any defined benefit plans maintained by the employer.
 - b. Because IRC 4972(c)(6)(B) was made effective retroactively for taxable years ending on or after December 31, 1992, certain employers that paid excise taxes imposed under IRC 4972 for taxable years ending on or after December 31, 1992 may have been entitled to excise tax refunds under this exception.
- (4) IRC 4972(c)(4) also provides a special rule for self-employed individuals that, for purposes of IRC 4972, treats certain excess amounts as amounts allowable as deductions under IRC 404.
 - a. The excess amount that is treated as an allowable deduction is the excess of the amount required to be contributed to a plan under IRC 412 on behalf of a self-employed individual (as defined in IRC 401(c)(1)), over the earned income (as defined in IRC 404(a)(8)) of such individual derived from the trade or business with respect to which such plan is established.

Exhibit 4.72.15-1 (06-14-2002)**Citations for Referenced Guidance and Brief Descriptions**

Revenue Rulings

Rev. Rul. 77-2, 1977-1 C.B. 120

Summary: Provides for the proper valuation recognition of changes in benefit structures that become effective after the valuation date.

Rev. Rul. 80-140, 1980-1 C.B. 89

Summary: Clarifies that the contribution of an employer's own term promissory note is not considered a payment to the trust for IRC 404(a) purposes, and this action is a prohibited transaction.

Rev. Rul. 81-195, 1981-2 C.B. 104

Summary: Specifies how the minimum funding requirements and maximum deductible limits can be impacted by funding for benefits limited to the maximum IRC 415 limits.

Rev. Rul. 81-215, 1981-2 C.B. 106

Summary: Details how certain anticipated IRC 415 increases (occurring within the plan year) can be taken into account in a reasonable funding method.

Rev. Rul. 84-146, 1984-2 C.B. 61

Summary: States that certain administrative fees paid in connection with a plan that meets the qualification requirements of IRC 401(a) are deductible under IRC 212 if they are ordinary and necessary expenses.

Rev. Rul. 86-142, 1986-2 C.B. 60

Summary: IRA contributions by IRA owners, and employer contributions to the trust of a qualified plan to reimburse the IRA and plan, respectively, for brokers fees, are not separately deductible as ordinary and necessary business expenses under IRC 162 or 212. Therefore, if the regular IRA or plan contributions are already at the deductible limit, the additional contributions would not be deductible for the tax year.

Rev. Rul. 88-68, 1988-2 C.B. 117

Summary: Certain payments made by a taxpayer (that uses the accrual method of accounting) to an independent contractor (that uses the cash receipts and disbursements method of accounting) that are part of a series of payments for services rendered and that are not scheduled to be paid until after 2 ½ months after the contractor's tax year end, are subject to IRC 404(d) and therefore not deductible until subsequent tax years.

Rev. Rul. 90-105, 1990-2 C.B. 69

Summary: Provides guidance on the application of IRC 404(a)(6) with regards to contributions to a 401(k) or matching contributions to a defined contribution plan.

Notices

Notice 94-38, 1984-1 C.B. 350

Summary: Stated the Service's position that amounts deducted as interest (as in *Albertson's Inc. v. Commissioner*, 12 F.3d 1529 (1993)) are only deductible in the year that such amounts are includible in income (a position that the Court agreed with *Albertson's Inc.* at the time).

Exhibit 4.72.15-1 (Cont. 1) (06-14-2002)

Citations for Referenced Guidance and Brief Descriptions

Announcements

Ann. 88-55, 1988-13 I.R.B. 35

Summary: Provides that contributions that are made to a pension plan for past service costs are subject to the uniform capitalization rules or long-term contract rules, effective for costs incurred after 1987.

Ann. 90-3, 1990-3 I.R.B. 36

Summary: Provides for the election process in order that multiple employer plans can be funded by the employers as if each employer maintained a separate plan.