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■ 14. Amend § 135.144 as follows:

■ A. In paragraph (a) introductory text, remove “of the following”;

■ B. In paragraph (b)(4) remove “or” following the semi-colon;

■ C. Redesignate paragraph (b)(5) as paragraph (b)(6);

■ D. Add new paragraph (b)(5); and

■ E. In paragraph (c) remove the reference “(b)(5)” and add in its place “(b)(6)”.

The addition reads as follows:

**§ 135.144 Portable electronic devices.**

\* \* \* \* \*

(b) \* \* \*

(5) Portable oxygen concentrators that comply with the requirements in § 135.91 of this part; or

\* \* \* \* \*

Issued under the authority provided by 49 U.S.C. 106(f) and 44701(a) in Washington, DC, on September 9, 2014.

**John S. Duncan,**

*Director, Flight Standards Service.*

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## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[REG-111839-13]

RIN 1545-BL62

#### Transitional Amendments To Satisfy the Market Rate of Return Rules for Hybrid Retirement Plans

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

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

**SUMMARY:** This document contains proposed regulations that would provide guidance regarding certain amendments to applicable defined

benefit plans. Applicable defined benefit plans are defined benefit plans that use a lump sum-based benefit formula, including cash balance plans and pension equity plans, as well as other hybrid retirement plans that have a similar effect. These proposed regulations would permit an applicable defined benefit plan that does not comply with the requirement that the plan not provide for interest credits (or equivalent amounts) at an effective rate that is greater than a market rate of return to comply with that requirement by changing to an interest crediting rate that is permitted under the final hybrid plan regulations, without violating the anti-cutback rules of section 411(d)(6). These regulations would affect sponsors, administrators, participants, and beneficiaries of these plans. This document also provides a notice of a public hearing on these proposed regulations.

**DATES:** Written or electronic comments must be received by December 18, 2014. Outlines of topics to be discussed at the public hearing scheduled for January 9, 2015, at 10 a.m. must be received by December 18, 2014.

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG-111839-13), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-111839-13), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC, or sent electronically, via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-111839-13). The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC.

**FOR FURTHER INFORMATION CONTACT:**

Concerning the regulations, Neil S. Sandhu or Linda S. F. Marshall at (202) 317-6700; concerning submissions of comments, the hearing, and/or being placed on the building access list to attend the hearing, Oluwafunmilayo (Funmi) Taylor at (202) 317-6901 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:**

**Background**

*I. In General*

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 411(b)(5) of the Internal Revenue Code (Code).

Generally, a defined benefit pension plan must satisfy the requirements of

section 411 in order to be qualified under section 401(a) of the Code. Section 411(b)(5), which modifies the accrual requirements of section 411(b), was added to the Code by section 701(b) of the Pension Protection Act of 2006, Public Law 109-280 (120 Stat. 780 (2006)) (PPA '06). Section 411(b)(5) and certain related effective date provisions were subsequently amended by the Worker, Retiree, and Employer Recovery Act of 2008, Public Law 110-458 (122 Stat. 5092 (2008)) (WRERA '08).

Under section 411(b)(5)(B)(i), a statutory hybrid plan is treated as failing to satisfy the requirements of section 411(b)(1)(H) (which provides that the rate of an employee's benefit accrual must not be reduced because of the attainment of any age) if the terms of the plan provide any interest credit (or an equivalent amount) for any plan year at a rate that is in excess of a market rate of return. Section 411(b)(5)(B)(i) is generally effective for plan years beginning after December 31, 2007.

Section 411(d)(6) provides generally that a plan does not satisfy section 411 if an amendment to the plan decreases a participant's accrued benefit. For this purpose, a plan amendment that has the effect of eliminating or reducing an early retirement benefit or a retirement-type subsidy or eliminating an optional form of benefit with respect to benefits attributable to service before the amendment is treated as reducing accrued benefits.

Sections 204(b)(5)(B)(i) and 204(g) of the Employee Retirement Income Security Act of 1974, Public Law 93-406 (88 Stat. 829 (1974)), as amended (ERISA), contain rules that are parallel to sections 411(b)(5)(B)(i) and 411(d)(6), respectively. Under section 101 of Reorganization Plan No. 4 of 1978 (43 FR 47713), the Secretary of the Treasury has interpretive jurisdiction over the subject matter addressed in these proposed regulations for purposes of ERISA, as well as the Code. Thus, these proposed regulations would apply for purposes of sections 411(b)(5)(B)(i) and 411(d)(6) of the Code, as well as for purposes of sections 204(b)(5)(B)(i) and 204(g) of ERISA.

Section 1.411(d)-4, A-2(b)(1), of the Income Tax Regulations provides, in part, that the Commissioner may, consistent with the provisions of § 1.411(d)-4, provide for the elimination or reduction of section 411(d)(6) protected benefits that have already accrued to the extent that such elimination or reduction is necessary to permit compliance with other requirements of section 401(a). The Commissioner may exercise this authority only through the publication

of revenue rulings, notices, and other documents of general applicability.

Section 1.411(d)-4, A-2(b)(2)(i), provides that a plan may be amended to eliminate or reduce a section 411(d)(6) protected benefit, within the meaning of § 1.411(d)-4, A-1, if the following three requirements are met: the amendment constitutes timely compliance with a change in law affecting plan qualification; there is an exercise of section 7805(b) relief by the Commissioner; and the elimination or reduction of the section 411(d)(6) protected benefit is made only to the extent necessary to enable the plan to continue to satisfy the requirements for qualified plans.

Final regulations (TD 9505) (2010 final hybrid plan regulations) were published by the Treasury Department and the IRS in the **Federal Register** on October 19, 2010 (75 FR 64123). The 2010 final hybrid plan regulations provide for certain interest crediting rates that satisfy the requirements of section 411(b)(5)(B)(i). The 2010 final hybrid plan regulations provide, effective for plan years that begin on or after January 1, 2012, a list of interest crediting rates and combinations of rates that satisfy the requirement of section 411(b)(5)(B)(i) that the plan not provide an effective rate of return in excess of a market rate of return, while not permitting other rates. The provisions that provide for a list of rates are set forth at § 1.411(b)(5)-1(d)(1)(iii), (d)(1)(vi), and (d)(6)(i).

Proposed regulations (REG-132554-08) (2010 proposed hybrid plan regulations) were also published by the Treasury Department and the IRS in the **Federal Register** on October 19, 2010 (75 FR 64197). The 2010 proposed hybrid plan regulations provide for additional interest crediting rates that satisfy the requirements of section 411(b)(5)(B)(i). The preamble to the 2010 proposed hybrid plan regulations solicited comments with respect to guidance needed to permit a plan to change its interest crediting rate to comply with the final hybrid plan regulations.

## II. Effective Dates

Notice 2011-85 (2011-44 IRB 605 (October 31, 2011)), (see § 601.601(d)(2)(ii)(b) of this chapter), announced delayed effective/applicability dates with respect to certain provisions in the hybrid plan regulations. Notice 2011-85 provided that the Treasury Department and the IRS intended to amend the hybrid plan regulations to postpone the effective/applicability date of § 1.411(b)(5)-1(d)(1)(iii), (d)(1)(vi), and (d)(6)(i), so

that these provisions would be effective at a future date, not earlier than January 1, 2013.

Notice 2011-85 also provided that, when the 2010 proposed regulations were finalized, it was expected that relief from the requirements of section 411(d)(6) would be granted for certain plan amendments that eliminate or reduce a section 411(d)(6) protected benefit. A plan amendment would be eligible for this relief only if the plan amendment were adopted by the last day of the first plan year preceding the plan year for which the 2010 proposed regulations, once finalized, apply to the plan, and the elimination or reduction was made only to the extent necessary to enable the plan to meet the requirements of section 411(b)(5). In addition, Notice 2011-85 extended the deadline for amending cash balance and other applicable defined benefit plans, within the meaning of section 411(a)(13)(C), to meet the requirements of section 411(a)(13) (other than section 411(a)(13)(A)) and section 411(b)(5), relating to vesting and other special rules applicable to these plans. Under Notice 2011-85, the deadline for these amendments is the same as the deadline for an amendment that is eligible for the relief under section 411(d)(6) that is also announced in the notice.

Notice 2012-61 (2012-42 IRB 479 (October 15, 2012)), (see § 601.601(d)(2)(ii)(b) of this chapter), announced that the regulations described in Notice 2011-85 would not be effective for plan years beginning before January 1, 2014.

Final regulations (TD 9693) (2014 final hybrid plan regulations) that finalize the 2010 proposed hybrid plan regulations are being issued at the same time as these proposed regulations. The 2014 final hybrid plan regulations amend the effective/applicability date of § 1.411(b)(5)-1(d)(1)(iii), (d)(1)(vi), and (d)(6)(i), so that these provisions apply to plan years that begin on or after January 1, 2016.

## III. Permissible Interest Crediting Rates

Interest crediting rates can be broadly characterized as either investment-based rates or rates that are not investment-based rates. An investment-based rate is a rate of return provided by actual investments, taking into account the return attributable to any change in the value of the underlying investments. A rate of return that is based on the rate of return for an index that measures the change in the value of investments can also be considered to be an investment-based rate. Rates that are not investment-based rates include fixed

rates of interest and yields to maturity of bonds.

Sections 1.411(b)(5)-1(d)(3) and (d)(4) set forth permitted rates that are not investment-based rates, such as the third segment rate described in section 417(e)(3)(D) or 430(h)(2)(C)(iii), the yield on 30-year Treasury Constant Maturities, and a fixed 6 percent rate of interest. Section 1.411(b)(5)-1(d)(5) sets forth permitted investment-based rates, such as the rate of return on certain regulated investment companies (RICs), as defined in section 851, and the rate of return on plan assets. As provided in § 1.411(b)(5)-1(d)(6), certain annual (or more frequent) floors are permitted in combination with the bond-based rates and cumulative floors (in excess of the cumulative zero floor required under section 411(b)(5)(i)(II)) are permitted in combination with either the bond-based rates or the investment-based rates.

## Explanation of Provisions

Prior to the first day of the first plan year that begins on or after January 1, 2016, a plan that uses an interest crediting rate that is not permitted under the final hybrid plan regulations must be amended to change to an interest crediting rate that is permitted under those regulations. Although a plan is permitted to be amended to change the interest crediting rate with respect to benefits that have not yet accrued, an amendment that reduces the interest crediting rate with respect to benefits that have already accrued would ordinarily be impermissible under section 411(d)(6).

In order to resolve this conflict between the market rate of return rules of section 411(b)(5)(B)(i) and the anti-cutback rules of section 411(d)(6), these proposed regulations would permit a plan with a noncompliant interest crediting rate to be amended with respect to benefits that have already accrued so that its interest crediting rate complies with the market rate of return rules. If the applicable requirements of these regulations are satisfied, such an amendment is permitted with respect to benefits that have already accrued, but only with respect to interest credits that are credited for interest crediting periods that begin on or after the later of the effective date of the amendment or the date the amendment is adopted (the applicable amendment date within the meaning of § 1.411(d)-3(g)(4)). To qualify for this treatment, the amendment would have to be adopted prior to and effective no later than the first day of the first plan year that begins on or after January 1, 2016.

These proposed regulations set forth amendments that would be eligible for

this treatment by providing a specific correction for each noncompliant feature of a noncompliant interest crediting rate.<sup>1</sup> If the noncompliant interest crediting rate has more than one noncompliant feature, then each noncompliant feature must be addressed separately in the prescribed manner. Examples are included to illustrate the application of these rules.

The general approach in the regulations is to permit amendments that bring the plan into compliance by changing the specific feature that causes the plan's interest crediting rate to be noncompliant, while not changing other features of the existing rate. For example, if a plan uses what would otherwise be a permissible bond-based rate but provides for an impermissible lookback month to determine interest credits, then the plan must be amended to correct the lookback month to a permitted lookback month while retaining the underlying bond-based rate. The Treasury Department and the IRS believe this general approach is the most appropriate manner to resolve the conflict between the market rate of return rules of section 411(b)(5)(B)(i) and the anti-cutback rules of section 411(d)(6).<sup>2</sup>

The proposed regulations take a special approach with respect to a noncompliant composite interest crediting rate that is determined as the greatest of two or more component rates, because it is not always readily apparent which specific feature or component rate causes the composite rate to be noncompliant. Two types of composite rates are specifically addressed in the proposed regulations, and a comment request is included to solicit suggestions for appropriate corrective amendments with respect to a third type of composite rate.

A composite rate that is the greater of an otherwise permissible variable bond-

based rate and a fixed minimum rate in excess of an annual interest crediting rate of 6 percent (the maximum permitted fixed rate) could be viewed either as: (1) A noncompliant fixed rate that must be brought into compliance by reducing the fixed rate and eliminating the variable bond-based rate component, or (2) a noncompliant bond-based rate that must be brought into compliance by reducing the fixed minimum rate to the highest permitted fixed minimum interest crediting rate that is permitted with the particular variable bond-based rate (4 or 5 percent, as applicable). As a result, in that particular case, the proposed regulations would give the plan sponsor the choice of either: (1) Eliminating the variable rate while changing to an annual interest crediting rate of 6 percent or (2) retaining the variable rate while reducing the fixed minimum component to the extent necessary to bring the plan into compliance. These same options would apply if the fixed minimum interest crediting rate is greater than the highest permitted fixed minimum interest crediting rate that is permitted with the particular variable bond-based rate but is not greater than the highest permitted fixed rate (6 percent).

In the case of a composite rate that is the greatest of two or more otherwise permissible variable bond-based rates, it is also difficult to determine the most appropriate method to bring the plan into compliance. One reason for this difficulty is because, in most of these cases, the composite rate will not exceed the rate of interest on long-term investment grade corporate bonds. As a result, in such a case, the proposed regulations do not provide for the elimination of any of the variable bond-based components. Instead, the proposed regulations would provide that the noncompliant composite rate must be capped at a third segment rate.<sup>3</sup>

The proposed regulations also take a special approach with respect to a noncompliant interest crediting rate that is an impermissible investment-based rate. One example of an impermissible investment-based rate is an investment-based rate that is not equal to the rate of return on a RIC or the actual rate of return on the aggregate assets of a plan or a specified subset of plan assets (even if the rate of return is reasonably expected to be not significantly more volatile than the broad United States equities market or a similarly broad international equities market). Another

example of an impermissible investment-based rate is the rate of return on a RIC that has most of its assets invested in securities of issuers (including other RICs) concentrated in an industry sector.

If an investment-based rate is noncompliant, the proposed regulations would require the plan sponsor to amend the plan to credit interest using a permitted investment-based rate with similar risk and return characteristics as the noncompliant rate, if possible. If it is not possible to select a permitted investment-based rate with similar risk and return characteristics as the noncompliant rate, then the proposed regulations would require the plan sponsor to amend the plan to credit interest using a permitted investment-based rate that is otherwise similar to the noncompliant rate (which would generally require the use of a rate that is less volatile than the noncompliant rate but is otherwise similar to the noncompliant rate).

Several commenters suggested that the IRS and the Treasury Department should permit a change from a noncompliant interest crediting rate to any of the maximum compliant interest crediting rates. However, this suggested approach was not taken in these proposed regulations because this approach would not require a sufficient connection between the correction and the specific feature that caused an interest crediting rate to be noncompliant, and would permit a plan sponsor to reduce the interest crediting rate more than is appropriate.

#### Proposed Effective/Applicability Dates

These regulations are proposed to apply to amendments adopted on or after the date regulations that finalize these proposed regulations are published in the **Federal Register**. In addition, it is proposed that taxpayers be permitted, pursuant to section 7805(b)(7), to elect to apply these regulations, as finalized, to plan amendments that are adopted during earlier periods.

#### Special Analyses

It has been determined that these proposed regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to

<sup>1</sup> A plan may have been amended to change its interest crediting rate under the rules of section 1107 of PPA '06. Section 1107 of PPA '06 provided relief from the requirements of section 411(d)(6) for amendments made pursuant to a change in law under PPA '06, if the amendment was adopted by the last day of the first plan year that began on or after January 1, 2009 (or 2011, in the case of a governmental plan as defined in section 414(d)). If an interest crediting rate adopted under the rules of section 1107 of PPA '06 is not permitted under the final hybrid plan regulations, then these proposed regulations would permit a subsequent amendment to change the rate to a rate permitted under the final hybrid plan regulations.

<sup>2</sup> The standard in these proposed regulations for resolving this conflict between section 411(d)(6) and section 411(b)(5)(B)(i) is generally comparable to the standard under the rules of § 1.411(d)-4, A-2(b)(1) and (b)(2)(i) with respect to the Commissioner's exercise of authority to resolve a conflict between section 411(d)(6) and another qualification requirement under section 401(a).

<sup>3</sup> Any of the rates that are denominated a third segment rate pursuant to § 1.411(d)(5)-1(d)(3) can be specified by a plan for this purpose, as well as for other purposes under these proposed regulations for which a third segment rate is used.

section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The Treasury Department and the IRS request comments on all aspects of the proposed rules.

In addition, comments are specifically requested as to the amendment required to bring a plan into compliance if the plan credits interest using a composite rate that is an investment-based rate of return with an impermissible annual (or more frequent) fixed or variable minimum rate. Some of these plans might currently be applying a reduction to the investment-based rate of return, in order to take into account the value provided by the minimum rate. For a plan that credits interest using an investment-based rate of return with an impermissible minimum rate:

- Should the required amendment eliminate the minimum rate (and eliminate any reduction to the investment-based rate of return), so that the required rate after amendment is the unreduced investment-based rate of return?
- Should the required amendment change the interest crediting rate to another permitted rate that is less volatile than the unreduced investment-based rate (such as a rate described in § 1.411(b)(5)–1(d)(3) with a fixed minimum rate of 4 percent per year)?
- Should the required amendment depend on the level of the minimum rate and the extent of any reduction to the investment-based rate of return?
- Should the plan sponsor have a choice among alternative required amendments to bring the plan into compliance?

Comments are also requested as to whether there are statutory hybrid plans other than those described in the specific request for comments that use a noncompliant interest crediting rate that is not addressed in the regulations and for which an amendment is necessary to bring the plan into compliance with the market rate of return rules. If so, comments are requested as to the appropriate amendment to bring the plan into compliance in such a case.

All comments will be available for public inspection and copying at [www.regulations.gov](http://www.regulations.gov) or upon request. A

public hearing has been scheduled for January 9, 2015, beginning at 10 a.m. in the Auditorium, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments by December 18, 2014 and submit an outline of topics to be discussed and the amount of time to be devoted to each topic (a signed original and eight (8) copies) by December 18, 2014.

A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

### Drafting Information

The principal authors of these regulations are Neil S. Sandhu and Linda S. F. Marshall, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in the development of these regulations.

### List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

### Proposed Amendments to the Regulations

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

### PART 1—INCOME TAXES

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

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

■ **Par. 2.** Section 1.411(b)(5)–1 is amended by adding paragraph (e)(3)(vi) to read as follows:

### § 1.411(b)(5)–1 Reduction in rate of benefit accrual under a defined benefit plan.

\* \* \* \* \*

(e) \* \* \*

(3) \* \* \*

(vi) *Transitional amendments needed to satisfy the market rate of return rules—(A) In general.* Notwithstanding the requirements of section 411(d)(6), if the requirements set forth in this paragraph (e)(3)(vi) are satisfied, a plan may be amended to change its interest crediting rate with respect to benefits that have already accrued in order to comply with the requirements of section 411(b)(5)(B)(i) and paragraph (d) of this section. A plan amendment is eligible for the treatment provided under this paragraph (e)(3)(vi)(A) to the extent that the amendment modifies an interest crediting rate that does not satisfy the requirements of section 411(b)(5)(B)(i) and paragraph (d) of this section in the manner specified in paragraph (e)(3)(vi)(C) of this section.

(B) *Rules of application—(1) Multiple noncompliant features.* If a plan's interest crediting rate has more than one noncompliant feature as described in paragraph (e)(3)(vi)(C) of this section, then each noncompliant feature must be addressed separately in the manner specified in paragraph (e)(3)(vi)(C) of this section.

(2) *Definition of investment-based rate.* The application of the rules of paragraph (e)(3)(vi)(C) of this section to an interest crediting rate depends on whether the interest crediting rate is an investment-based rate. For purposes of this paragraph (e)(3)(vi), an investment-based rate is either a rate of return provided by actual investments (taking into account the return attributable to any change in the value of the underlying investments) or a rate that is based on the rate of return for an index that measures the change in the value of investments.

(3) *Timing rules for permitted amendments.* The rules under this paragraph (e)(3)(vi) apply only to a plan amendment that is adopted prior to and effective no later than the first day of the first plan year described in paragraph (f)(2)(i)(B) of this section. In addition, the rules under this paragraph (e)(3)(vi) apply to a plan amendment only with respect to interest credits that are credited for interest crediting periods that begin after the applicable amendment date (within the meaning of § 1.411(d)–3(g)(4)).

(C) *Noncompliant feature and amendment to bring plan into compliance—(1) Timing rules not satisfied.* If a plan does not satisfy the timing rules relating to how interest credits are determined and credited (as

set forth in paragraph (d)(1)(iv) of this section), then the plan must be amended to correct the aspect of the plan's interest crediting rate that fails to comply with those rules with respect to its underlying interest crediting rate.

(2) *Fixed rate in excess of 6 percent.*

If a plan credits interest using a fixed rate in excess of the rate described in paragraph (d)(4)(v) of this section, then the plan must be amended to reduce the interest crediting rate to an annual interest crediting rate of 6 percent.

(3) *Bond-based rate with margin exceeding maximum permitted margin.* If a plan credits interest using a rate that would be described in paragraph (d)(3) or (d)(4) of this section except that the plan applies a margin that exceeds the maximum permitted margin under paragraph (d)(3) or (d)(4) of this section, then the plan must be amended to reduce the margin to the maximum permitted margin for the underlying rate used by the plan.

(4) *Bond-based rate with fixed minimum rate exceeding maximum permitted fixed minimum rate.* If a plan credits interest using a variable rate described in paragraph (d)(3) or (d)(4) of this section in combination with a fixed minimum rate in excess of the highest permitted fixed minimum rate under paragraph (d)(6)(ii)(A)(2) or (B)(2) of this section (as applicable), then the plan must be amended either—

(i) To reduce the fixed minimum rate to the highest permitted fixed minimum rate that can be used in combination with the plan's variable rate; or

(ii) To credit interest using an annual interest crediting rate of 6 percent.

(5) *Greatest of two or more variable bond-based rates.* If a plan credits interest using a composite rate that is the greatest of two or more variable rates described in paragraph (d)(3) or (d)(4) of this section, then the plan must be amended to credit interest using the lesser of the composite rate and a rate described in paragraph (d)(3) of this section.

(6) *Impermissible bond-based rate.* If a plan credits interest using a variable rate that is not an investment-based rate of return and is not described in paragraph (d)(3) or (d)(4) of this section (after application of the rule of paragraph (e)(3)(vi)(C)(3) of this section, if applicable), then—

(i) If a variable rate described in paragraph (d)(3) or (d)(4) of this section that has similar duration and quality characteristics as the plan's variable rate can be selected, then the plan must be amended to credit interest based on such a rate; or

(ii) If a variable rate described in paragraph (d)(3) or (d)(4) of this section

that has similar duration and quality characteristics as the plan's variable rate cannot be selected, then the plan must be amended to provide that the plan credits interest using the lesser of the plan's variable rate and a rate described in paragraph (d)(3) of this section.

(7) *Impermissible investment-based rate.* If a plan credits interest using an investment-based rate of return that is not described in paragraph (d)(5) of this section, then—

(i) If a permitted investment-based rate described in paragraph (d)(5)(ii)(A), (d)(5)(ii)(B), or (d)(5)(iv) of this section that has similar risk and return characteristics as the plan's impermissible investment-based rate can be selected, then the plan must be amended to credit interest based on such a permitted investment-based rate; or

(ii) If a permitted investment-based rate described in paragraph (d)(5)(ii)(A), (d)(5)(ii)(B), or (d)(5)(iv) of this section that has similar risk and return characteristics as the plan's impermissible investment-based rate cannot be selected, then the plan must be amended to credit interest based on a rate of return described in paragraph (d)(5)(ii)(A), (d)(5)(ii)(B), or (d)(5)(iv) of this section that is otherwise similar to the plan's impermissible investment-based rate (generally requiring the use of a rate that is less volatile than the plan's impermissible investment-based rate but is otherwise similar to that rate).

(D) *Examples.* The following examples illustrate the application of the rules of this paragraph (e)(3)(vi). Each plan has a plan year that is the calendar year, and all amendments are adopted on October 1, 2015 and become effective for interest crediting periods beginning on or after January 1, 2016.

*Example 1.* (i) *Facts.* A plan determines interest credits for a plan year using the average yield on 30-year Treasury Constant Maturities for the last week of the preceding plan year (which is an impermissible period for this purpose pursuant to paragraph (d)(1)(iv)(B) of this section because it is not a month).

(ii) *Conclusion.* Pursuant to paragraph (e)(3)(vi)(C)(1) of this section, the plan must be amended to determine interest credits for a plan year using the average yield on 30-year Treasury Constant Maturities for a period that complies with the requirements of paragraph (d)(1)(iv)(B) of this section.

*Example 2.* (i) *Facts.* The facts are the same as in *Example 1*, except that the plan's interest crediting rate is determined as the average yield on 30-year Treasury Constant Maturities for the period, plus 50 basis points.

(ii) *Conclusion.* Pursuant to paragraph (e)(3)(vi)(B)(1) of this section, the plan must be amended to correct both the impermissible lookback period and the

excess margin. Accordingly, pursuant to paragraph (e)(3)(vi)(C)(1) and (3) of this section, the plan must be amended to determine interest credits for a plan year using the average yield on 30-year Treasury Constant Maturities (with no margin) for a period that complies with the requirements of paragraph (d)(1)(iv)(B) of this section.

*Example 3.* (i) *Facts.* A plan credits interest for a plan year using the rate of return on plan assets for the preceding plan year.

(ii) *Conclusion.* Pursuant to paragraph (e)(3)(vi)(C)(1) of this section, the plan must be amended to determine interest credits for each plan year using the rate of return on plan assets for that plan year.

*Example 4.* (i) *Facts.* A plan credits interest using the average yield on 30-year Treasury Constant Maturities for December of the preceding plan year with a minimum rate of 5.5 percent per year.

(ii) *Conclusion.* Pursuant to paragraph (e)(3)(vi)(C)(4) of this section, the plan must be amended to change the plan's interest crediting rate. The new interest crediting rate under the plan must be either the average yield on 30-year Treasury Constant Maturities for December of the preceding plan year with a minimum rate of 5 percent per year or an annual interest crediting rate of 6 percent.

*Example 5.* (i) *Facts.* A plan credits interest using the greater of the unadjusted yield on 30-year Treasury Constant Maturities and the yield on 1-year Treasury Constant Maturities plus 100 basis points.

(ii) *Conclusion.* Pursuant to paragraph (e)(3)(vi)(C)(5) of this section, the plan must be amended to credit interest using the lesser of a third segment rate described in paragraph (d)(3) of this section and the composite rate used under the plan before the amendment (the greater of the unadjusted yield on 30-year Treasury Constant Maturities and the yield on 1-year Treasury Constant Maturities plus 100 basis points).

*Example 6.* (i) *Facts.* A plan credits interest using a broad-based index that measures the yield to maturity on a group of long-term investment grade corporate bonds.

(ii) *Conclusion.* Pursuant to paragraph (e)(3)(vi)(C)(6)(i) of this section, the plan must be amended to credit interest using a third segment rate described in paragraph (d)(3) of this section.

*Example 7.* (i) *Facts.* A plan credits interest using the rate of return for a broad-based index that measures the yield to maturity on a group of short-term non-investment grade corporate bonds.

(ii) *Conclusion.* Pursuant to paragraph (e)(3)(vi)(C)(6)(ii) of this section, the plan must be amended to credit interest at the lesser of the rate of return for the index used under the plan before the amendment date and a third segment rate described in paragraph (d)(3) of this section.

*Example 8.* (i) *Facts.* A plan credits interest using the rate of return for the S&P 500 index. To bring the plan into compliance with the market rate of return rules, the plan sponsor amends the plan to credit interest based on the rate of return on a RIC that is designed to track the rate of return on the S&P 500 index.

(ii) *Conclusion.* The amendment satisfies the rule of paragraph (e)(3)(vi)(C)(7)(i) of this section.

*Example 9. (i) Facts.* A plan credits interest based on the rate of return on a collective trust that holds a balanced portfolio of equity and fixed income investments, which provides a rate of return that is reasonably expected to be not significantly more volatile than the broad U.S. equities market or a similarly broad international equities market. To bring the plan into compliance with the market rate of return rules, the plan sponsor amends the plan to credit interest based on the actual rate of return on the assets within a specified subset of the plan's assets that is invested in the collective trust.

(ii) *Conclusion.* The amendment satisfies the rule of paragraph (e)(3)(vi)(C)(7)(i) of this section.

\* \* \* \* \*

**John Dalrymple,**

*Deputy Commissioner for Services and Enforcement.*

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## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[REG-105739-11]

**RIN 1545-BK08**

#### **Removal of Allocation Rule for Disbursements From Designated Roth Accounts to Multiple Destinations**

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

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** This document contains proposed amendments to the regulations that address the tax treatment of distributions from designated Roth accounts under tax-favored retirement plans. The proposed regulations would limit the applicability of the rule regarding the allocation of after-tax amounts when disbursements are made to multiple destinations so the allocation rule applies only to distributions made before the earlier of January 1, 2015 or a date chosen by the taxpayer that is on or after September 18, 2014. These regulations would affect administrators of, employers maintaining, participants in, and beneficiaries of designated Roth accounts under tax-favored retirement plans.

**DATES:** Written or electronic comments and requests for a public hearing must be received by December 18, 2014.

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG-105739-11), Room

5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-105739-11), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC, or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-105739-11).

#### **FOR FURTHER INFORMATION CONTACT:**

Concerning the regulations, Michael P. Brewer at (202) 317-6700; concerning submission of comments or to requests for a public hearing, Oluwafunmilayo (Funmi) Taylor at (202) 317-6901 (not toll-free numbers).

#### **SUPPLEMENTARY INFORMATION:**

##### **Background**

Section 402(a) provides generally that any amount distributed from a trust described in section 401(a) that is exempt from tax under section 501(a) is taxable to the distributee under section 72 in the taxable year of the distributee in which distributed. Under section 403(b)(1), any amount distributed from a section 403(b) plan is also taxable to the distributee under section 72.

If a participant's account balance in a plan qualified under section 401(a) or in a section 403(b) plan includes both after-tax and pretax amounts, then, under section 72(e)(8), each distribution (other than a distribution that is paid as part of an annuity) from the plan will include a pro rata share of both after-tax and pretax amounts. (Under section 72(d), a different allocation method applies to annuity distributions.)

Under section 402A(d)(4), section 72 is applied separately with respect to distributions and payments from a designated Roth account and other distributions and payments from the plan.

Section 402(c) prescribes rules for amounts that are rolled over from qualified trusts to eligible retirement plans, including individual retirement accounts or annuities ("IRAs"). Subject to certain exceptions, section 402(c)(1) provides that if any portion of an eligible rollover distribution paid to an employee from a qualified trust is transferred to an eligible retirement plan, the portion of the distribution so transferred is not includible in gross income in the taxable year in which paid.

Under section 402(c)(2), the maximum portion of an eligible rollover distribution that may be rolled over in a transfer to which section 402(c)(1) applies generally cannot exceed the

portion of the distribution that is otherwise includible in gross income. However, under section 402(c)(2)(A) and (B), the general rule does not apply to such a distribution to the extent that such portion is transferred in a direct trustee-to-trustee transfer to a qualified trust or to an annuity contract described in section 403(b) and such trust or contract provides for separate accounting for amounts so transferred (and earnings thereon), 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 such portion is transferred to an IRA.

In addition, section 402(c)(2) that, in the case of a transfer described in subparagraph (A) or (B), the amount transferred shall be treated as consisting first of the portion of such distribution that is includible in gross income (determined without regard to section 402(c)(1)).

Under section 402A, an applicable retirement plan may include a designated Roth account. An applicable retirement plan is defined in section 402A(e)(1) to mean a plan qualified under section 401(a), a section 403(b) plan, and a governmental section 457(b) plan. Section 402A(d) provides that a qualified distribution (as defined in section 402A(d)(2)) from a designated Roth account is not includible in gross income.

Section 1.402A-1, Q&A-5(a), of the Income Tax Regulations prescribes taxability rules for a distribution from a designated Roth account that is rolled over. Q&A-5(a) provides, in part, that "any amount paid in a direct rollover is treated as a separate distribution from any amount paid directly to the employee."

Section 402(f) requires that the plan administrator of a plan qualified under section 401(a) provide any recipient of an eligible rollover distribution with a written explanation describing certain provisions of law. Notice 2009-68, 2009-2 CB 423 (September 28, 2009), contains two safe harbor explanations that may be provided to recipients of eligible rollover distributions from an employer plan in order to satisfy section 402(f). The safe harbor explanation with respect to distributions that are not from a designated Roth account provides in part (under the heading "If your payment includes after-tax contributions") that "[i]f you do a direct rollover of only a portion of the amount paid from the Plan and a portion is paid to you, each of the payments will include an allocable portion of the after-tax contributions." Similarly, for distributions from a designated Roth