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(Also, Part I, § 412.)

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SECTION 1. PURPOSE AND SCOPE

.01 This revenue procedure provides approval to change the funding method used to determine the minimum funding standard for defined benefit plans as further described below. The approval under this revenue procedure is granted in accordance with § 412(c)(5) of the Internal Revenue Code and section 302(c)(5) of the Employee Retirement Income Security Act of 1974 (ERISA). Section 3 provides approval to change the funding method of the plan to one of seventeen methods, including a change in the asset valuation method to one of six asset valuation methods, a change in the valuation date to the first day of the plan year, and a change in the method for valuing ancillary benefits to the method used to value retirement benefits. Section 4 provides approvals for certain changes that become necessary or expedient under special circumstances.

.02 Any changes in funding method under this revenue procedure must satisfy the rules of Section 5 concerning the continued maintenance of certain amortization bases, the creation of an amortization base resulting from the change in method (method change base), and the amortization period for the method change base. Taxpayers, plan administrators, and enrolled actuaries are cautioned to consider the overall restrictions for use of this procedure (see section 6.01), the additional restrictions for approval of any of the changes listed in section 3 (see section 6.02), and specific restrictions described under each of the approvals. Approval for changes not provided by this revenue procedure may be requested from the Internal Revenue Service.

.03 The funding method changes approved in this revenue procedure also apply for purposes of § 404. However, calculations under the funding method for purposes of § 404 may require certain modifications to elements in the calculations. For example, for purposes of § 412, the value of assets used in the determination of the normal cost under an aggregate funding method is adjusted for any credit balance or funding deficiency in the funding standard account. The value of assets is not adjusted in that manner for purposes of § 404 but is, instead, adjusted for any undeducted contributions (see § 1.404(a)–14(d)(2) of the Income Tax Regulations).

.04 The application of a funding method must conform to all of the requirements of the regulations under § 412. Thus, for example, in a method which allocates liabilities among different elements of past and future service, the allocation of liabilities must be reasonable as required under § 1.412(c)(3)–1(c)(5).

SECTION 2. BACKGROUND

.01 Section 412(c)(5)(A), as amended, and section 302(c)(5)(A) of ERISA, Pub. L. 93–406, 1974–3 C.B. 1, 40, as amended, state that if the funding method of a plan is changed, the new funding method shall become effective only if the change is approved by the Secretary.

.02 Section 1.412(c)(1)–1 provides that the term "funding method", when used in § 412 of the Code, has the same meaning as the term "actuarial cost method" in section 3(31) of ERISA. Section 1.412(c)(1)–1 of the regulations further provides that the funding method of a plan includes not only the overall funding method used by the plan but also each specific method of computation used in applying the overall method. Therefore, for example, the funding method of a plan includes the date on which assets and liabilities are valued (the valuation date). The funding method also includes the definition of compensation which is used to determine the normal cost or accrued liability. Furthermore, a change in a particular aspect of a funding method does not change any other aspects of that method. For example, a change in funding method from the unit credit to the level dollar individual entry age normal method does not change the current valuation date or asset valuation method used for the plan.

.03 Section 1.412(c)(2)–1 generally provides that a change in the actuarial valuation method used to value the assets of a plan is a change in funding method that requires approval under § 412(c)(5) of the Code.

.04 Rev. Proc. 95–51, 1995–2 C.B. 431, as modified by Rev. Proc. 98–10, 1998–1 C.B. 279, and by Rev. Proc. 99–45, 1999–49 I.R.B. 603, granted approval for certain changes in funding method. Rev. Proc. 2000–41, 2000–42 I.R.B. 371, provides the procedure by which a plan administrator or plan sponsor may obtain approval of the Secretary of the Treasury for a change in funding method.

SECTION 3. APPROVAL FOR SPECIFIED CHANGES

Subject to the applicability restrictions of section 6 and to the individual conditions under each method below, approval is granted for a change to one of the following funding methods. The development of the normal cost is described for each of the funding methods provided in subsections .01, through .09. For funding methods that directly calculate an accrued liability, within the meaning of Rev. Rul. 81–13, 1981–1 C.B. 229, the development of the accrued liability is also described.

.01 Approval 1. Approval is granted for a change in funding method to the unit credit funding method described below.

(1) This approval does not apply if the plan is a cash balance plan. For this purpose, a cash balance plan is a defined benefit plan that defines any portion of an employee's benefits by reference to the employee's hypothetical account, where such hypothetical account is determined by reference to hypothetical allocations and hypothetical earnings that are designed to mimic the actual allocations of contributions and earnings to an employee's account that would occur under a defined contribution plan.

(2) Under this method, the normal cost is the sum of the individual normal costs for all active participants. An individual normal cost is the sum of the normal costs for the various benefits valued using the method. The normal cost for each benefit is the present value of the portion of the projected benefit at each expected separation date that is allocated to the current plan year as set forth in paragraphs (5) and (6) below. For purposes of this approval, separation date includes any date of benefit commencement, if earlier.

(3) The accrued liability under the method is the sum of the individual accrued liabilities for each participant. An individual's accrued liability is the sum of the accrued liabilities for the various benefits valued using the method. The accrued liability for each benefit is the present value of the portion of the projected benefit at each expected separation date that is allocated to prior plan years as set forth in paragraphs (4), (5), and (6) below.

(4) For a participant other than an active participant, or for a beneficiary, the projected benefit is the accrued retirement benefit, or other plan benefit, under the terms of the plan and the projected benefit is allocated to prior plan years.

(5) For an active participant, when valuing all benefits other than ancillary benefits that are not directly related to the accrued retirement benefit, the projected benefit related to a particular separation date is the benefit determined for the participant under the plan's benefit formula(s) calculated using the projected compensation and the projection, under respective assumptions, of any other components that would be used in the calculation of the benefit on the expected separation date. The projected benefit at each expected separation date is allocated to the years of credited service as follows.

(a) The portion of the projected benefit allocated to the current plan year is determined as

(i) the benefit that would be determined for the participant under the plan's benefit formula(s) calculated using the projected compensation, if applicable, and the projection, under respective assumptions, of any other components that would be used in the calculation of the benefit on the expected separation date, except taking into account only credited service through the end of the current plan year, minus

(ii) the benefit that would be determined for the participant under the plan's benefit formula(s) calculated using the projected compensation, if applicable, and the projection, under respective assumptions, of any other components that would be used in the calculation of the benefit on the expected separation date, except taking into account only credited service through the beginning of the current plan year.

(b) The portion of the projected benefit allocated to prior plan years is the benefit determined for the participant under the plan's benefit formulas calculated using the projected compensation, if applicable, and the projection, under respective assumptions, of any other components that would be used in the calculation of the benefit on the expected separation date, except taking into account only credited service through the beginning of the current plan year (i.e., the amount in subparagraph (a)(ii) above).

(c) Notwithstanding that the allocations in subparagraphs (a) and (b) only take into account credited service as of the beginning and end of the plan year, if a participant is expected to satisfy an eligibility requirement for a particular benefit that is being valued (e.g., subsidized early retirement benefit) as of an expected separation date, the amounts in subparagraphs (a) and (b), and in paragraph (6) below, must be determined as if the employee has satisfied the eligibility requirement.

(d) The portion of the projected benefit allocated to prior plan years may not be less than the participant's actual accrued benefit as of the beginning of the current plan year. In addition, the benefit determined as of the end of the current plan year in subparagraph (a)(i) above may not be less than the participant's estimated accrued benefit as of the end of the current plan year.

(6) For active participants, when valuing ancillary benefits that are not directly related to the accrued retirement benefit, the projected benefit related to a particular separation date is the benefit determined for the participant under the plan's benefit formula(s) calculated using the projected compensation and the projection, under respective assumptions, of any other components that would be used in the calculation of the benefit on the expected separation date. The portion of the projected benefit allocated to the current plan year is the projected benefit at the expected separation date divided by the number of years of service the participant will have at such date. The portion of such projected benefit allocated to prior years of service is the projected benefit multiplied by a fraction, the numerator of which is the number of years of service at the beginning of the plan year, and the denominator of which is the number of years of service the participant will have at the expected separation date.

(7) The unfunded liability equals the total accrued liability less the actuarial value of plan assets. All present values are determined as of the valuation date.

(8) The following examples illustrate the application of the method.

(a) Example 1. The retirement benefit under the terms of a plan is equal to 1.3% of high 1-year compensation per year of service, but not less than the top-heavy minimum of 2% of high 5-year average compensation for each year the plan is top-heavy (not exceeding 20%), as required under § 416(c). Compensation under the plan is limited to $100,000. The plan has been top-heavy only for the last 7 years. Employee E has 10 years of service at the beginning of the current plan year. E's compensation for that year is $30,000. The compensation is assumed to increase at the rate of 5% compounded yearly. The particular benefit being valued is the early retirement benefit anticipated to commence at the expected separation date 7 years in the future (i.e., after completion of 17 years of service). At this separation date, the employee will be eligible for early retirement, and will have projected compensation of $40,202, and projected high 5-year average compensation of $36,552. The allocated benefits determined for Employee E at the beginning and end of the plan year, and on the separation date, are shown in the table below.

Allocated Benefit Determined Under Plan	Determined As of the Beginning of Plan Year	End of Plan Year	Separation Date
(1) 1.3% Benefit Formula	$5,226[1]	$5,749[1]	$8,885[3]
(2) Top-Heavy Formula	$5,117[2]	$5,848[2]	$7,310[3]
(3) Allocated Benefit (greater of (1) and (2))	$5,226	$5,848	$8,885

FOOTNOTES

[1]$5,226 = $40,202 x 1.3% x 10; $5,749 = $40,202 x 1.3% x 11
[2]$5,117 = $36,552 x 2.0% x 7; $5,848 = $36,552 x 2.0% x 8
[3]$8,885 = $40,202 x 1.3% x 17; $7,310 = $36,552 x 2.0% x 10

The benefit allocated to the current year is $622 ($5,848- $5,226), and the benefit allocated to prior years is $5,226. In this case, the projected benefit at the separation date is based on the 1.3% benefit formula, and the current year's benefit allocation of the projected benefit results in an amount which is based on the 1.3% benefit formula at the beginning of the year and on the top-heavy formula at the end of the year.

(b) Example 2: Plan B is an accumulation plan within the meaning of § 1.401(a)(4)–12. The benefit formula under Plan B for each plan year is 1% of compensation for such year. The sum of the amounts for each of the years constitutes an employee's benefit. The accrued benefit at any date under Plan B is the benefit payable at normal retirement age for the years of service to date. Employee F has 3 years of service at the beginning of the year. The benefit being valued is the normal retirement benefit payable at the normal retirement date (the date Employee F reaches normal retirement age). At normal retirement age, Employee F will have 20 years of service. Compensation is assumed to increase at a rate of 5% per year. Employee F's compensation was $28,665, $27,170, and $26,000 for the prior year, the second prior year, and the third prior year, respectively. For valuation purposes, Employee F's compensation for the current year is assumed to be $30,098. During the preceding plan year, Plan B was amended effective on the first day of the current plan year to provide that with respect to all prior plan years, the normal retirement benefit is updated to the greater of the benefit actually accumulated as of the beginning of the current plan year or 1% of the preceding year's compensation multiplied by the number of years of service prior to the beginning of the current plan year.

The benefit determined for Employee F, taking into account only credited service through the beginning of the current plan year under the plan's benefit formula is $860 (the greater of (a) $818 ((1% x $26,000) + (1% x $27,170) + (1% x $28,665)), or (b) $860 (1% x $28,665 x 3)). Taking the amendment into account, the projected benefit payable at normal retirement age is $8,637 ($860 + (1% x $30,098 x 25.84), where 25.84 is the accumulation of $1 payable at the end of the year for 17 years determined at 5% interest). For purposes of allocating the projected benefit, changes in compensation assumed for later plan years are not taken into account in accordance with the plan's benefit formula. The benefit allocated to the current plan year is $301 ((860 + (1% x $30,098)) - 860).

.02 Approval 2. Approval is granted for a change in funding method to the level percent of compensation aggregate funding method described below.

(1) This approval applies only to plans which provide for compensation-related benefits.

(2) Under this method, the normal cost is calculated in the aggregate as the normal cost accrual rate multiplied by the total compensation of all active participants.

(a) The normal cost accrual rate is

(i) the total present value of future benefits of all participants and beneficiaries less adjusted assets, divided by

(ii) the total, for all active participants, of the present value of the compensation expected to be paid to each participant for each year of the participant's anticipated future service, determined as of the participant's attained age.

(b) For this purpose, the adjusted assets are equal to

(i) the actuarial value of the assets, plus

(ii) the sum of the outstanding balances of the amortization bases established on account of funding waivers under § 412(b)(2)(C), switchback to the regular funding standard under § 412(b)(2)(D), use of the shortfall method under § 1.412(c)(1)–2, and the transition under § 1.412(c)(3)–2(d), minus

(iii) the credit balance (or plus the funding deficiency), if any, in the funding standard account.

.03 Approval 3. Approval is granted for a change in funding method to the level dollar aggregate funding method described below.

(1) Under this method, the normal cost is calculated in the aggregate as the normal cost per active participant multiplied by the number of active participants.

(a) The normal cost per active participant is

(i) the total present value of future benefits of all participants and beneficiaries, less adjusted assets, divided by

(ii) the total, for all active participants, of the present value of an annuity of $1 per year for every year of a participant's anticipated future service, determined as of the participant's attained age.

(b) For this purpose, the adjusted assets are equal to

(i) the actuarial value of the assets, plus

(ii) the sum of the outstanding balances of the amortization bases established on account of funding waivers under § 412(b)(2)(C), switchback to the regular funding standard under § 412(b)(2)(D), use of the shortfall method under § 1.412(c)(1)–2 of the regulations, and the transition under § 1.412(c)(3)–2(d), minus

(iii) the credit balance (or plus the funding deficiency), if any, in the funding standard account.

.04 Approval 4. Approval is granted for a change in funding method to the level percent of compensation individual aggregate funding method described below.

(1) This approval applies only for plans which provide for compensation-related benefits.

(2) This approval does not apply if the actuarial value of assets is less than the present value of benefits for inactive participants and beneficiaries, or if the amount in paragraph (3)(b)(i) is less than zero.

(3) Under this method, the normal cost is the sum of the individual normal costs for each active participant.

(a) The normal cost for an active participant is

(i) the present value of future benefits for the participant, less allocated adjusted assets, divided by

(ii) the ratio of (A) the present value of the compensation expected to be paid to the participant for each year of the participant's anticipated future service, determined as of the participant's attained age, to (B) the participant's current compensation.

(b) For this purpose, allocated adjusted assets are calculated as follows:

(i) First, the adjusted value of the assets is equal to:

(A) the actuarial value of the assets, plus

(B) the sum of the outstanding balances of the amortization bases established on account of funding waivers under § 412(b)(2)(C), switchback to the regular funding standard under § 412 (b)(2)(D), use of the shortfall method under § 1.412(c)(1)–2, and the transition under § 1.412(c)(3)–2(d), minus

(C) the credit balance (or plus the funding deficiency), if any, in the funding standard account, minus

(D) any liabilities retained by the plan for any inactive participant or beneficiary.

(ii) In the first year the method is used, the allocated adjusted value of the assets for an active participant is calculated by allocating the adjusted value of the assets in proportion to the present value of accrued benefits, or in proportion to the accrued liability determined under one of the immediate gain funding methods described in subsection .01 or .08.

(iii) For years subsequent to the first year in which the method is used, the adjusted value of the assets is allocated to an active participant in the proportion that

(A) the sum of the allocated adjusted assets and calculated normal cost as of the valuation date for the prior year for that active participant bears to

(B) the total of the amounts in (A) for all active participants.

.05 Approval 5. Approval is granted for a change in funding method to the level dollar individual aggregate funding method described below.

(1) This approval does not apply if the actuarial value of assets is less than the present value of benefits of inactive participants and beneficiaries, or if the amount in paragraph (2)(b)(i) is less than zero.

(2) Under this method, the normal cost is the sum of the individual normal costs for each active participant.

(a) The normal cost for an active participant is

(i) the present value of future benefits for the participant less allocated adjusted assets, divided by

(ii) the present value of an annuity of $1 per year for every year of the participant's anticipated future service, determined as of the participant's attained age.

(b) For this purpose, allocated adjusted assets are calculated as follows:

(i) First, the adjusted value of the assets is equal to:

(A) the actuarial value of the assets, plus

(B) the sum of the outstanding balances of the amortization bases established on account of funding waivers under § 412(b)(2)(C), switchback to the regular funding standard under § 412(b)(2)(D), use of the shortfall method under § 1.412(c)(1)-2, and the transition under § 1.412(c)(3)-2(d), minus

(C) the credit balance (or plus the funding deficiency), if any, in the funding standard account, minus

(D) any liabilities retained by the plan for any inactive participant or beneficiary.

(ii) In the first year the method is used, allocated adjusted assets for an active participant is calculated by allocating the adjusted value of the assets in proportion to the present value of accrued benefits, or in proportion to the accrued liability determined under one of the immediate gain funding methods described in subsection .01 or .09.

(iii) For years subsequent to the first year in which the method is used, the adjusted value of the assets is allocated to an active participant in the proportion that

(A) the sum of the allocated adjusted assets and calculated normal cost as of the valuation date for the prior year for that active participant bears to

(B) the total of the amounts in (A) for all active participants.

.06 Approval 6. Approval is granted for a change in funding method to the level percent of compensation frozen initial liability funding method described below.

(1) This approval applies only for plans which provide for compensation-related benefits.

(2) Under this method, the normal cost is calculated in the aggregate, for every year the method is used including the first, as the normal cost accrual rate multiplied by the total compensation of all active participants.

(a) The normal cost accrual rate is

(i) the total present value of future benefits of all participants and beneficiaries less the sum of the actuarial value of assets and the unfunded liability, divided by

(ii) the total, for all active participants, of the present value of the compensation expected to be paid to each participant for each year of the participant's anticipated future service, determined as of the participant's attained age.

(b) As of the date of change, the unfunded liability is set equal to the unfunded accrued liability determined under the level percentage of compensation individual entry age normal funding method described in subsection .08.

(c) For years subsequent to the plan year of the change in method, the unfunded liability equals

(i) the unfunded liability for the prior plan year, plus the normal cost for the prior plan year (the result adjusted with appropriate interest to the valuation date), minus the actual contribution(s) for the prior plan year (adjusted with appropriate interest to the valuation date), and

(ii) the unfunded liability is further increased (or decreased) by the amount of any base established on the valuation date which results from a plan amendment or a change in assumptions. Such bases are amortized over the period(s) described in § 412(b)(2)(B) or § 412(b)(3)(B), as applicable.

.07 Approval 7. Approval is granted for a change in funding method to the level dollar frozen initial liability funding method described below.

(1) Under this method, the normal cost is calculated in the aggregate, for every year the method is used including the first, as the normal cost per active participant multiplied by the number of active participants.

(a) The normal cost per active participant is

(i) the total present value of future benefits of all participants and beneficiaries less the sum of the actuarial value of assets and the unfunded liability, divided by

(ii) the total, for all active participants, of the present value of an annuity of $1 per year for every year of a participant's anticipated future service, determined as of the participant's attained age.

(b) As of the date of change, the unfunded liability is set equal to the unfunded accrued liability determined under the level dollar individual entry age normal funding method described in subsection .09.

(c) For years subsequent to the plan year of the change in method, the unfunded liability equals

(i) the unfunded liability for the prior plan year, plus the normal cost for the prior plan year (the result adjusted with appropriate interest to the valuation date), minus the actual contribution(s) for the prior plan year (adjusted with appropriate interest to the valuation date), and

(ii) the unfunded liability is further increased (or decreased) by the amount of any base established on the valuation date which results from a plan amendment or a change in assumptions. Such bases are amortized over the period(s) described in § 412(b)(2)(B) or § 412(b)(3)(B), as applicable.

.08 Approval 8. Approval is granted for a change in funding method to the level percent of compensation individual entry age normal funding method described below.

(1) This approval does not apply if the alternative minimum funding standard account is used at any time within the 5-year period commencing with the first day of the plan year for which the change is made.

(2) This approval applies only for plans which provide for compensation-related benefits.

(3) Under this method, the normal cost is the sum of the individual normal costs for all active participants. For an active participant, the normal cost is the participant's normal cost accrual rate, multiplied by the participant's current compensation.

(a) The normal cost accrual rate equals

(i) the present value of future benefits for the participant, determined as of the participant's entry age, divided by

(ii) the present value of the compensation expected to be paid to the participant for each year of the participant's anticipated future service, determined as of the participant's entry age.

(b) In calculating the present value of future compensation, the salary scale must be applied both retrospectively and prospectively to estimate compensation in years prior to and subsequent to the valuation year based on the compensation used for the valuation.

(c) The accrued liability is the sum of the individual accrued liabilities for all participants and beneficiaries. A participant's accrued liability equals the present value, at the participant's attained age, of future benefits less, the present value at the participant's attained age of the individual normal costs payable in the future. A beneficiary's accrued liability equals the present value, at the beneficiary's attained age, of future benefits. The unfunded accrued liability equals the total accrued liability less the actuarial value of assets.

(d) Under this method, the entry age used for each active participant is the participant's age at the time he or she would have commenced participation if the plan had always been in existence under current terms, or the age as of which he or she first earns service credits for purposes of benefit accrual under the current terms of the plan. Alternatively, the entry age may be determined as the age at the valuation date next following the time described in the preceding sentence.

.09 Approval 9. Approval is granted for a change in funding method to the level dollar individual entry age normal funding method described below.

(1) This approval does not apply if the alternative minimum funding standard account is used at any time within the 5-year period commencing with the first day of the plan year for which the change is made.

(2) Under this method, the normal cost is the sum of the individual normal costs for all active participants.

(a) For an active participant, the individual normal cost equals

(i) the present value of future benefits for the participant, determined as of the participant's entry age, divided by

(ii) the present value of an annuity of $1 per year for every year of the participant's anticipated future service, determined as of the participant's entry age.

(b) The accrued liability is the sum of the individual accrued liabilities for all participants and beneficiaries. A participant's accrued liability equals the present value, at the participant's attained age, of future benefits, less the present value at the participant's attained age of the individual normal costs payable in the future. A beneficiary's accrued liability equals the present value, at the beneficiary's attained age, of future benefits. The unfunded accrued liability equals the total accrued liability less the actuarial value of the plan assets.

(c) Under this method, entry age used for each active participant is the participant's age at the time he or she would have commenced participation if the plan had always been in existence under current terms, or the age as of which he or she first earns service credits for purposes of benefit accrual under the current terms of the plan. Alternatively, the entry age may be determined as the age at the valuation date next following the time described in the preceding sentence.

.10 Approval 10. Approval is granted for a change in asset valuation method to fair market value as defined in § 1.412(c)(2)–1(c).

.11 Approval 11. Approval is granted for a change in asset valuation method to the average value as defined in § 1.412(c)(2)–1(b)(7) (which does not have a phase-in), or to any alternative formulation that is algebraically equivalent to this average value. The asset value determined under the method will be adjusted to be no greater than 120% and no less than 80% of the fair market value defined in § 1.412(c)(2)–1(c).

For example, under § 1.412(c)-(2)–1(b)(7), if the averaging period is five years, the average value is based on the fair market value of assets in the current year and the adjusted values of assets for the prior four years as provided in § 1.412(c)(2)–1(b)(8). An alternative formulation which is algebraically equivalent to this method is one in which the average value of assets is equal to the fair market value on the valuation date, minus decreasing fractions (4/5, 3/5, 2/5 and 1/5, in this example) of the appreciation and depreciation of the assets in each of the four preceding years. The stated averaging period may not exceed five (5) plan years.

.12 Approval 12. Approval is granted for a change in asset valuation method to the average value (as defined in § 1.412(c)(2)–1(b)(7)), modified to use the phase-in described below, or to any alternative formulation that is algebraically equivalent to this average value. The asset value determined under the method will be adjusted to be no greater than 120% and no less than 80% of the fair market value defined in § 1.412(c)(2)–1(c).

In the first year this method is used, the average value is calculated as in Approval 11, except that the adjusted values for all but the most recent prior year are replaced by the adjusted value for the most recent prior year. In the second year, the average is calculated as in Approval 11, except that the values for all but the most recent two prior years are replaced by the adjusted value for the second most recent prior year. This process is continued until values for all prior years in the averaging period are phased in. The stated averaging period may not exceed five (5) plan years.

.13 Approval 13. Approval is granted for a change in the valuation date to the day that is the first day of the plan year.

.14 Approval 14. Approval is granted to change the funding method used for valuing ancillary benefits to the funding method used to value retirement benefits, if the prior method for valuing ancillary benefits had been the one-year term method. For this purpose, ancillary benefits are defined in § 1.412(c)(3)–1(f)(2) and include pre-retirement death and disability benefits.

.15 Approval 15. Approval is granted for a change in asset valuation method to the smoothed market value (without phase-in) described below, or to any alternative formulation that is algebraically equivalent to this smoothed value. The asset value determined under the method will be adjusted to be no greater than 120% and no less than 80% of the fair market value defined in § 1.412(c-(2)–1(c).

Under this method, the actuarial value of assets is equal to the market value of assets less a decreasing fraction (i.e., (n-1)/n, (n-2)/n, etc., where n equals the number of years in the smoothing period) of the gain or loss for each of the preceding n-1 years. The stated smoothing period may not exceed five (5) plan years.

Under this method, a gain or loss for a year is determined by calculating the difference between the expected value of the assets for the year and the market value of the assets at the valuation date. The expected value of the assets for the year is the market value of the assets at the valuation date for the prior year brought forward with interest at the valuation interest rate to the valuation date for the current year plus contributions minus disbursements (i.e., benefits and expenses), all adjusted with interest at the valuation rate to the valuation date for the current year. If the expected value is less than the market value, the difference is a gain. Conversely, if the expected value is greater than the market value, the difference is a loss.

For example, if the smoothing period is five years, the actuarial value of the assets will be the market value of the plan's assets, with gains subtracted or losses added at the rates described as follows:

(i) 4/5 of the prior year's gain or loss
(ii) 3/5 of the second preceding year's gain or loss
(iii) 2/5 of the third preceding year's gain or loss
(iv) 1/5 of the fourth preceding year's gain or loss

.16 Approval 16. Approval is granted for a change in asset valuation method to the smoothed market value (with phase-in) described below, or to any alternative formulation that is algebraically equivalent to this smoothed value. The asset value determined under the method will be adjusted to be no greater than 120% and no less than 80% of the fair market value defined in § 1.412(c)(2)–1(c).

In the first year this method is used the actuarial value of assets is equal to the market value as of the valuation date. In each subsequent year, the smoothed value is calculated in the same manner as in Approval 15, except that the only gains or losses recognized are those occurring in the year of the change and in later years. The stated smoothing period may not exceed five (5) plan years.

.17 Approval 17. Approval is granted for a change in asset valuation method to the average value (as defined in § 1.412(c)(2)–1(b)(7)), modified to use the alternative phase-in as described below, or to any alternative formulation that is algebraically equivalent to this average. The asset value determined under the method will be adjusted to be no greater than 120% and no less than 80% of the fair market value defined in § 1.412(c)(2)–1(c).

In the first year this method is used, the actuarial value of assets is equal to the market value. In the second year, the average value is calculated in the same manner as in Approval 11, except that the averaging period is two years. In the third year, the average value is calculated in the same manner as in Approval 11, except that the averaging period is three years. This process continues until the stated averaging period (not to exceed five years) is reached.

SECTION 4. SPECIAL APPROVALS

.01 Approvals to Remedy Unreasonable Allocation of Costs.

(1) If a plan uses an individual aggregate funding method and an individual normal cost becomes negative for a participant, approval is granted to re-allocate excess assets to other participants in proportion to the present value of accrued benefits, or in proportion to the accrued liability determined under the immediate gain funding method described in section 3.01, section 3.08 (only if the normal cost for a participant is determined as a level percent of compensation under the plan's method), section 3.09 (only if the normal cost for a participant is determined as a level dollar amount under the plan's method) or in proportion to the allocated adjusted assets prior to the reallocation. For this purpose, excess assets are defined as the excess, if any, of the assets currently allocated to the participant over the present value of the participant's future benefits.

(2) If a plan uses a spread gain funding method which establishes an initial unfunded liability using an immediate gain funding method (e.g., frozen initial liability or attained age normal), and the normal cost and/or unfunded liability become(s) negative, then, in the case where the normal cost under the plan's method is determined as a level percentage of compensation, approval is granted to reestablish the unfunded liability under the funding method described in section 3.01 if the unfunded liability was originally established under the unit credit method, or under the funding method described in section 3.08 if the unfunded liability was originally established under the entry age normal method. See Rev. Rul. 81–213, 1981–2 C.B. 101, regarding whether a funding method is a spread gain funding method or an immediate gain funding method. In the case where the normal cost under the plan's method is determined as a level dollar amount, approval is granted to reestablish the unfunded liability under the funding method described in section 3.01 if the unfunded liability was originally established under the unit credit method, or under the funding method described in section 3.09 if the unfunded liability was originally established under the entry age normal method. If the reestablished unfunded liability is less than zero, approval is granted to change to the aggregate funding method described in section 3.02 (if the normal cost under the plan's method is determined as a level percent of compensation), or section 3.03 (if the normal cost under the plan's method is determined as a level dollar amount).

(3) If a plan that uses a spread gain funding method which establishes an initial unfunded liability using an immediate gain funding method (e.g., frozen initial liability or attained age normal), becomes fully funded within the meaning of § 412(c)(6) (without taking into account § 412(c)(7)(A)(i)(I)), approval is granted to change to the aggregate funding method described in section 3.02 (if the normal cost under the plan's method is determined as a level percent of compensation), or section 3.03 (if the normal cost under the plan's method is determined as a level dollar amount).

(4) If a plan uses an individual aggregate funding method and the actuarial value of plan assets is less than the present value of benefits for inactive participants and beneficiaries, or if the actuarial value of the assets, plus the sum of the outstanding balances of the amortization bases established on account of funding waivers under § 412(b)(2)(C), switchback to the regular funding standard under § 412(b)(2)(D), use of the shortfall method under § 1.412(c)(1)–2, and the transition under § 1.412(c)(3)–2(d), minus the credit balance (or plus the funding deficiency), if any, in the funding standard account, minus any liabilities retained by the plan for any inactive participant or beneficiary is less than zero, approval is granted to change to the aggregate funding method described in section 3.02 (if the normal cost under the plan's method is determined as a level percent of compensation), or section 3.03 (if the normal cost under the plan's method is determined as a level dollar amount).

(5) If a plan provides that no participant may accrue a benefit as of a date that is no later than the first day of the plan year, approval is granted to change to the unit credit method described in section 3.01.

.02 Approval for Change in Funding Method for Fully Funded Terminated Plans.

(1) For a plan year during which a plan is terminated, the funding method may be changed to a method described in paragraph (2) provided that the conditions set forth in paragraph (3) are satisfied. As part of the change in method, the valuation date may be changed to the date of termination or the first day of the plan year, and the asset valuation method may be changed to value plan assets at fair market value.

(2) A method is described in this subsection if the normal cost for the plan year is the present value of the benefits accruing in the plan year, and the accrued liability is the present value of the benefits accrued as of the first day of the plan year.

(3) The conditions in this subsection are satisfied if:

(a) As of the date of termination, the fair market value of the assets of the plan (exclusive of contributions receivable) is not less than the present value of all benefit liabilities (whether or not vested), and

(b) if applicable, a timely notice of intention to terminate was filed with the Pension Benefit Guaranty Corporation (PBGC).

.03 Approval for Takeover Plans.

(1) Approval is granted by this paragraph for a change in funding method where all the conditions set forth in paragraphs (2) through (4) are satisfied.

(2) There has been both a change in the enrolled actuary for the plan and a change in the business organization providing actuarial services to the plan.

(3) The method used by the new actuary is substantially the same as the method used by the prior actuary, and is consistent with the information contained in the prior actuarial valuation reports or prior Schedules B of Form 5500. Also, the method used by the new actuary must be applied to the prior year (using the assumptions of the prior actuary) and the absolute value of each resulting difference in normal cost, accrued liability (if directly computed under the method) and actuarial value of assets, that is attributable to the change in cost method, does not exceed five percent (5%) of the respective amounts calculated by the prior actuary for that year.

(4) The change in costs due to the change in method is treated in the same manner as an experience gain or loss, unless the actuarial assumptions are being changed, in which case the change in method is treated as part of the change in assumptions.

.04 Approval for Change in Valuation Software

(1) Approval is granted for a change in method that results from a change in valuation software where all the conditions set forth in paragraphs (2) through (8) are satisfied. Note that certain changes in valuation software may not constitute changes in funding method. For example, the update of the valuation software to incorporate the actual social security taxable wage base for the current year is not a change in funding method. Also, if all of the results of each specific computation are the same after the change in valuation software, there is no change in funding method.

(2) There has been a modification to the computations in the valuation software or a different valuation software system has been used. Examples of modifications to the computations in the valuation software include a change from commutation functions to direct calculation of actuarial values, changes in the rounding conventions or changes to correct errors or inefficiencies in the computations. Examples of using a different valuation software system include a change in the spreadsheet software (e.g., Lotus 1-2-3 to Excel) or a change in the actuarial software vendor.

(3) The underlying method is unchanged and is consistent with the information contained in the prior actuarial valuation reports and prior Schedules B of Form 5500.

(4) The modification to the computations in the valuation software or the use of a different valuation software system is designed to produce results that are no less accurate than the results produced prior to the modification or change.

(5) The net charge to the funding standard account for the year (or for the prior year) determined using the new software does not differ from the net charge to the funding standard account determined using the old software (all other factors being held constant) by more than two percent (2%).

(6) A change in valuation software requiring approval was not made for the prior plan year.

(7) Section 4.04 (Approval for Takeover Plans) of this revenue procedure is not applicable to the change.

(8) The effect of the change in method is treated in the same manner as an experience gain or loss, unless the actuarial assumptions are being changed, in which case the effect of the change in method is treated as part of the effect of the change in assumptions.

.05 Approval for *De Minimis* Mergers

(1) Approval is granted for a change in method in connection with a merger described in paragraph (2) where the procedures set forth in paragraphs (3) through (5) below are followed.

(2) The merger involves the merger of a smaller plan (within the meaning of § 1.414(l)–1(h)(1)) and a larger plan (within the meaning of § 1.414(l)–1(h)(1)). For purposes of this paragraph (2), the rules of §§ 1.414(l)–1(h)(2), 1.414(l)–1(h)(3), and 1.414(l)–1(h)(4) apply in determining whether a merger is *de minimis*.

(3) For the period from the beginning of the plan year of the smaller plan to the date of the merger, the charges and credits to the funding standard account for the smaller plan are determined without regard to the merger. If that period is less than a full 12-month plan year, the charges and credits to the funding standard account for the smaller plan for this period are ratably adjusted using the principles of Rev. Rul. 79–237, 1979–2 C.B. 190, in the same manner as if the date of the merger was the date of plan termination of the smaller plan. The deductible limit under § 404 for contributions to the smaller plan is determined by treating the period from the beginning of the plan year to the date of merger as a short plan year and following the procedure set forth in section 5 of Rev. Proc. 87–27, 1987–1 C.B. 769. Schedule B of Form 5500 is filed for the smaller plan for the period from the beginning of the plan year of the smaller plan to the date of the merger. Any contributions made for the smaller plan after the date of the merger, but not later than 8 1/2 months after the date of the merger, are credited to the funding standard account of the smaller plan for this period. For purposes of applying § 4971(b) (but not § 4971(a)) with respect to the smaller plan, any funding deficiency that existed for the smaller plan is considered corrected as of the date of merger.

(4) If the valuation date for the larger plan for the plan year in which the merger occurs precedes the date of the merger, the charges and credits to the funding standard account for the larger plan for that plan year are determined without regard to the merger. Consequently, Schedule B of Form 5500 for the plan year of the larger plan in which the merger occurs is filed without regard to the merger in such a case. Similarly, the deductible limit determined under § 404 with respect to the plan year of the larger plan in which the merger occurs is determined without regard to the merger.

(5) For the actuarial valuation of the larger plan as of the valuation date coincident with or next following the date of the merger, the funding method (including asset valuation method) used is that for the larger plan, and the funding method (including asset valuation method) used

for the smaller plan is disregarded. The charges and credits to the funding standard account for the larger plan are determined by treating the net effect of the change in assets and liabilities due to the merger in the same manner as any other gain or loss experienced by the larger plan. Consequently, any amortization bases, credit balances, or funding deficiencies with respect to the smaller plan are disregarded for purposes of applying § 412 and § 4971 with respect to the larger plan.

.06 Approval for Certain Mergers With Same Plan Year And Merger Date of First or Last Day of Plan Year

(1) Approval is granted for a change in method that results from a merger of one plan with another plan in a given plan year where all the conditions set forth in paragraphs (2) through (6) are satisfied, and the procedures set forth in paragraphs (7) through (13) are followed.

(2) The merger is not a *de minimis* merger within the meaning of § 1.414-(l)–1(h).

(3) The funding method (without regard to the asset valuation method) used for each of the plans is a method described in section 3.

(4) Both plans have the same plan year and a valuation date that is either the first or last day of the plan year.

(5) The date of the merger is either the first day of the plan year or the last day of the plan year of the two plans.

(6) In a case in which the date of the merger is the first day of the plan year, neither plan has a funding deficiency for the prior plan year. In a case in which the date of the merger is the last day of the plan year, neither plan has a funding deficiency for the plan year of the merger (after taking into account contributions made after the date of the merger as provided in paragraph (13) below).

(7) If the date of the merger is the first day of the plan year, the minimum funding standard of § 412 and the deductible limit of § 404 are determined for the merged plan for the entire plan year in which the merger occurs in the manner provided in paragraphs (8), (9), (10), (11), and (12) below. Consequently, for the plan year in which the merger occurs, only one Schedule B of Form 5500 is filed for the merged plan in such a case.

(8) If the same asset valuation method (in all respects) is used for each of the two plans, the asset valuation method of the merged plan is that method. If the same asset valuation method (in all respects) is not used for each of the two plans (for example, the smoothing period is three years for one of the plans and five years for the other plan), the asset valuation method used for the merged plan must be an asset valuation method described in section 3.

(9) If the funding method (without regard to the asset valuation method) used for each of the two plans is the same, that funding method is continued for the plan after the merger. If the funding method (without regard to the asset valuation method) used for each of the two plans is not the same, then the funding method used for the ongoing plan is continued after the merger. For this purpose, the ongoing plan is the plan as designated by the plan administrator (within the meaning of § 414(g)), whose name and plan number will continue to be reported on Schedule B of Form 5500 for years after the merger. The funding method used for the plan which is not the ongoing plan is disregarded.

(10) An experience gain or loss is determined separately for each of the two plans, for the period prior to the date of the merger, without regard to the merger and any associated changes (i.e., changes in funding method, actuarial assumptions, or plan benefits). The preceding sentence applies only to the extent that an experience gain or loss would have been determined under the methods used for the plans prior to the merger.

(11) All amortization bases that were maintained for the two plans continue to be maintained for the merged plan to the extent they would be maintained under the funding method used for the merged plan. The credit balances, if any, of each of the two plans from the prior year are carried forward to the current plan year and combined.

(12) If an unfunded liability is determined under the funding method used for the ongoing plan, it must be determined after any change in actuarial assumptions and methods (including a change in asset valuation method pursuant to paragraph (8)). In the case of such a funding method that is a spread gain method, the unfunded liability is redetermined in the same manner that the unfunded liability was originally determined for the ongoing plan. Therefore, the amortization base established pursuant to the rules of section 5.01(2) will reflect any change of actuarial assumptions and methods. For purposes of this paragraph, a spread gain method is any method that does not directly calculate an accrued liability. See Rev. Rul. 81–13 for whether a funding method directly calculates an accrued liability.

(13) If the date of the merger is the last day of the plan year, the minimum funding standard under § 412 and the deductible limit under § 404 for each of the plans for the plan year in which the merger occurs are determined without regard to the merger. Consequently, separate Schedules B of Form 5500 are filed for the plans for the plan year in which the merger occurs without regard to the merger in such a case. Any contribution for the plan year that is made to the trust after the date of the merger may be credited on either of the Schedules B provided that the contribution is made for such plan within the period described in § 412-(c)(10). For the plan year following the plan year in which the merger occurs, the minimum funding standard and the deductible limit are determined for the plan after the merger by following the procedures set forth in paragraphs (8), (9), (10), (11) and (12) above as if the merger occurred on the first day of such following plan year.

.07 Approval for Certain Mergers With Transition Period No More Than 12 Months

(1) Approval is granted for a change in method that results from a merger of one plan with another plan where all the conditions set forth in paragraphs (2) through (7) are satisfied, and the procedures set forth in paragraphs (8) through (15) are followed.

(2) The merger is not a *de minimis* merger within the meaning of § 1.414-(l)–1(h).

(3) The funding method (without regard to the asset valuation method) used for each of the plans is a method described in section 3.

(4) Each of the plans, prior to the merger, had a valuation date that was the first day of the plan year.

(5) The plans do not have the same plan year, or, if both plans have the same plan

year, the date of the merger is not the first day or the last day of the plan year.

(6) The period from the first day of the plan year of the plan that is not the ongoing plan to the end of the plan year of the ongoing plan (as defined in section 4.06(9) above) in which the merger takes place (the "transition period") does not exceed 12 months.

(7) The ongoing plan does not have a funding deficiency for the prior plan year, and the plan that is not the ongoing plan does not have a funding deficiency for the short plan year described in (8) below.

(8) For the period from the beginning of the plan year of the plan that is not the ongoing plan to the date of the merger (the "short plan year"), the charges and credits to the funding standard account for such plan are determined without regard to the merger. For the short plan year, the charges and credits to the funding standard account for that plan are ratably adjusted using the principles of Rev. Rul. 79–237 in the same manner as if the date of the merger was the date of plan termination of that plan, and a Schedule B of Form 5500 is filed for the short plan year. Any contributions made for that plan after the date of the merger, but not later than 8 1/2 months after the date of the merger, are credited to the funding standard account of that plan for the short plan year.

(9) Charges and credits attributable to the plan that is not the ongoing plan for the period, if any, from the date of the merger to the end of the plan year of the ongoing plan (the "interim period") are determined without regard to the merger as set forth in this paragraph. Accordingly, the charges and credits are determined based upon the funding method, actuarial assumptions, and valuation results used for purposes of paragraph (8) above, and are ratably adjusted to reflect the length of the interim period. Such charges and credits should include interest to reflect the period from the valuation date (of the plan that is not the ongoing plan) to the date of the merger, as well as interest for the interim period. The credit balance, if any, at the end of the short plan year described in paragraph (8) above is carried forward to the beginning of the interim period.

(10) Unless the date of the merger is the first day of the plan year of the ongoing plan, the funding standard account for the ongoing plan for the plan year in which the merger occurs is determined in steps. In the first step the funding standard account for the ongoing plan is determined without regard to the merger. In the second step, charges and credits attributable to the plan that is not the ongoing plan are determined for the interim period as described in paragraph (9) above. In the third step the charges and credits from the first two steps are combined in a manner similar to the treatment for separate plans under § 413(c)(4)(A) except that the credit balance or funding deficiency for each plan at the end of the year are combined to determine an overall credit balance or funding deficiency. Schedule B of Form 5500 is filed for the ongoing plan for the plan year in which the merger occurred with the combined entries to the funding standard account as described above. The other entries on the Schedule B (e.g. lines dealing with accrued liability) should be those for the ongoing plan without regard to the merger.

(11) For the plan year of the ongoing plan following the plan year in which the merger occurs the funding method for the ongoing plan is determined in accordance with the rules set forth in paragraphs (11), (12), and (13). If the same asset valuation method (in all respects) is used for each of the two plans, the asset valuation method of the merged plan is that method. If the same asset valuation method (in all respects) is not used for each of the two plans (for example, the smoothing period is three years for one of the plans, and five years for the other plan), the asset valuation method used for the merged plan must be an asset valuation method described in section 3. If the funding method (without regard to the asset valuation method) used for each of the two plans is the same, that funding method is continued for the plan after the merger. If the funding method (without regard to the asset valuation method) used for each of the two plans is not the same, then the funding method used for the ongoing plan is continued after the merger. The funding method used for the plan which is not the ongoing plan is disregarded.

(12) An experience gain or loss is determined separately for each of the two plans, for the period prior to the valuation date for the plan year following the plan year in which the merger occurred, without regard to the merger and any associated changes (i.e., changes in funding method, actuarial assumptions, or plan benefits). The preceding sentence applies only to the extent that an experience gain or loss would have been determined under the methods used for the plans prior to the merger.

(13) All amortization bases that were maintained for the two plans continue to be maintained for the ongoing plan to the extent they would be maintained under the funding method used for the ongoing plan. If an unfunded liability is determined under the funding method used for the ongoing plan, it must be determined after any change in actuarial assumptions and methods (including a change in asset valuation method pursuant to paragraph (12)). In the case of a funding method that is a spread gain method, the unfunded liability is redetermined in the same manner that the unfunded liability was originally determined for the ongoing plan. Therefore, the amortization base established pursuant to the rules of section 5.01(2) will reflect any change of actuarial assumptions and methods. For purposes of this paragraph, a spread gain method is any method that does not directly calculate an accrued liability. See Rev. Rul. 81–13 for whether a funding method directly calculates an accrued liability.

(14) The deductible limit under § 404 for the plan that is not the ongoing plan for the short plan year is determined, without regard to the merger, following the procedures set forth in section 5 of Rev. Proc. 87–27. The deductible limit under § 404 for the plan that is the ongoing plan is determined for the plan year in which the merger occurs as the sum of the limit determined for the plan without regard to the merger plus the limit determined with respect to the plan that is not the ongoing plan for the interim period described in paragraph (9) above.

(15) If the date of the merger is the first day of the plan year of the ongoing plan, the minimum funding standard and the deductible limit under § 404 are determined under this paragraph (15). The minimum funding standard and deductible limit under § 404 are determined for the short plan year as described in paragraphs (8) and (14) above as if the merger occurred on the last day of the preceding plan year of the ongoing plan.

However, as there is no interim period, the calculations described in paragraphs (9) and (10) are not made. Instead, the minimum funding standard and deductible limit under § 404 for the plan year of the merger will fully reflect the merger in the manner described in paragraphs (11), (12), and (13).

(16) The following example illustrates the application of this subsection.

(a) Plan A has a plan year that begins on October 1 and ends on the following September 30. The valuation date for Plan A is October 1, the first day of the plan year.

(b) Plan B has a plan year that begins on July 1 and ends on the following June 30. The valuation date for Plan B is July 1, the first day of the plan year.

(c) Plan A is merged into Plan B on April 1, 2001.

(d) An actuarial valuation was made with respect to Plan A as of October 1, 2000, for the plan year commencing October 1, 2000, using the entry age normal method as described in section 3.09 with the actuarial value of the assets determined using the smoothing method described in section 3.15. The valuation interest rate for Plan A is 6 percent. The relevant valuation results are as follows: the normal cost equals $5,000; the unfunded accrued liability equals $50,000; the credit balance from the prior year equals $10,000; the amortization charges equals $6,938; and the outstanding balance of amortization bases equal $60,000. Plan A has no unfunded current liability. No contribution was made to Plan A for the short plan year from October 1, 2000, through April 1, 2001.

(e) An actuarial valuation was made with respect to Plan B as of July 1, 2000, for the plan year commencing July 1, 2000, using the entry age normal method as described in section 3.08 with the actuarial value of the assets determined as the fair market value of the assets. The valuation interest rate for Plan B is 8 percent. The relevant valuation results are as follows: the normal cost equals $8,000; the unfunded accrued liability equals $101,000; the credit balance from the prior year equals $19,000; the amortization charges equal $11,428; and the outstanding balance of amortization bases equals $120,000. Plan B has no unfunded current liability.

(f) For Plan A, the period from October 1, 2000, to April 1, 2001, is treated as a short plan year for purposes of § 412. The charges and credits to the funding standard are determined based upon the October 1, 2000, actuarial valuation without regard to the merger and are ratably adjusted to reflect the short plan year from October 1, 2000, to April 1, 2001. A Schedule B of Form 5500 is filed for the short plan year with the relevant entries for the funding standard account reported as follows: the normal cost is $2,500 (1/2 times $5,000), the amortization charge is $3,469 (1/2 times $6,938), and the interest on the normal cost and amortization charge is $176 (for the period from October 1, 2000, through April 1, 2001). Thus, the total charges are $6,145. The credits to the funding standard account that are reported on the Schedule B are $10,295 representing the prior year credit balance of $10,000 plus $295 interest for the short plan year. As a result, a credit balance of $4,150 ($10,295 less $6,145) is reported on the Schedule B as of April 1, 2001.

(g) For Plan B, the minimum funding standard for the plan year beginning July 1, 2000, is determined in steps as described in paragraph (10) above.

First, the minimum funding standard is determined for Plan B without regard to the merger using the July 1, 2000, actuarial valuation. Thus, the normal cost would be $8,000, the amortization charge would be $11,428, and interest on these amounts (using the 8 percent interest rate) would be $1,554, and the total charges would be $20,982. The credits (without regard to employer contributions) would be the credit balance of $19,000 plus interest (at 8 percent) of $1,520 for total credits of $20,520. Accordingly, Plan B would have a funding deficiency of $462 ($20,982 minus $20,520) if there were no employer contributions and the merger was disregarded.

Second, charges and credits attributable to Plan A are determined for the interim period (from April 1, 2001 (the date of the merger) to June 30, 2001 (the end of the plan year of the ongoing plan in which the merger occurs)). The charges consist of a normal cost of $1,287 (3/12 of $5,000 adjusted for one half years interest at 6 percent), an amortization charge of $1,786 (3/12 of $6,938 adjusted for one half years interest at 6 percent), plus interest of $45 (for the interim period at 6 percent) for total charges of $3,118. The credits (without regard to employer contributions) consist of the credit balance of $4,150 (from the Schedule B for the short plan year from October 1, 2000, to April 1, 2001) plus interest (at 6 percent for the interim period) of $61 for total credits of $4,211. Accordingly, for the interim period from April 1, 2001, to June 30, 2001, the charges and credits attributable to Plan A would result in a credit balance of $1,093 (the excess of $4,211 over $3,118) if there were no employer contribution and the merger was disregarded.

Third, the charges and credits for the first two steps are combined except that the credit balance or funding deficiency that were separately determined at the end of the year are combined to determine an overall credit balance or funding deficiency. Thus, the charges reported on the 2000 Schedule B for Plan B would consist of a normal cost of $9,287 ($8,000 plus $1,287), an amortization charge of $13,214 ($11,428 plus $1,786), interest charge of $1,599, and total charges of $24,100 ($20,982 plus $3,118). The credits reported on the 2000 Schedule B for Plan B would consist of a prior year credit balance of $23,150 ($19,000 plus $4,150), interest credits of $1,581 ($1,520 plus $61), and total credits of $24,731 ($20,520 plus $4,211). The credit balance reported on the 2000 Schedule B as of June 30, 2001, would be $631 ($1,093 minus $462).

(h) With the July 1, 2001, actuarial valuation for Plan B, the funding method for the plan as merged is the entry age normal method with the actuarial value of the assets determined using a method described in section 3. An amortization base is established pursuant to section 5 to reflect the change in funding method.

.08 Approval for Other Mergers With Transition Period More Than 12 Months

(1) Approval is granted for a change in method that is otherwise described in section 4.07 (except that the transition period described in section 4.07(6) exceeds 12 months) if the procedures set forth in paragraphs (2) through (6) are followed. If, however, the date of the merger is the first day of the plan year of the ongoing plan, the merger is treated as occurring on the day before the first day of the plan year of the ongoing plan. In such a case, the length of the transition period would be less than 12 months, and the rules of section 4.07 apply.

(2) For the period from the beginning of the plan year of the plan that is not the ongoing plan to the date of the merger (the "short plan year"), the charges and credits to the funding standard account for that plan are determined without regard to the merger. For the short plan year, the charges and credits to the funding standard account for that plan are ratably adjusted using the principles of Rev. Rul. 79–237 in the same manner as if the date of the merger was the date of plan termination of that plan, a Schedule B of Form 5500 is filed for that plan for the short plan year. Any contributions made for that plan after the date of the merger, but not later than 8 1/2 months after the date of the merger, are credited to the funding standard account of that plan for the short plan year.

(3) Charges and credits attributable to the plan that is not the ongoing plan for the period from the date of the merger to the end of the plan year of the plan that is the ongoing plan (the "interim period") are determined without regard to the merger as set forth in this paragraph (3). Accordingly, the charges and credits are determined based upon the funding method, actuarial assumptions, and valuation results used for purposes of paragraph (2) above.

(a) For the period from the date of the merger to the date that would have been the end of the plan year of the plan that is not the ongoing plan had there been no merger (the "first partial period"), the charges and credits to the funding standard account are determined by ratably adjusting the charges and credits determined under paragraph (2) above to reflect the length of the first partial period. Such charges and credits should include interest to reflect the period from the valuation date (of the plan that is not the ongoing plan) to the date of the merger, as well as interest for the interim period. The credit balance at the end of the short plan year described in paragraph (2) above is carried forward to the beginning of the first partial period.

(b) For the period from the date that would have been the end of the plan year of the plan that is not the ongoing plan had there been no merger to the end of the plan year of the ongoing plan in which the merger occurs (the "second partial period"), the charges and credits to the funding standard account are determined based upon the expected normal cost amortization charge, and amortization credit from the valuation used for purposes of paragraph (2) above, and are ratably adjusted to reflect the length of the second partial period. Such charges and credits should include interest for the second partial period. In addition, if the funding method used for the plan that is not the ongoing plan is a funding method that directly calculates an accrued liability within the meaning of Rev. Rul. 81–13, an amortization base is developed to reflect the gain or loss with respect to assets for the short plan year by comparing the expected and actual value of the assets. For this purpose, the expected value of the assets is computed as the market value of the assets determined for purposes of paragraph (2), plus contributions made for the short plan year described in paragraph (2), minus disbursements (i.e., benefit payments and expenses determined on either an actual or expected basis), with all items adjusted for expected interest at the valuation rate for the period to the date of the merger. The actual value of the assets is set to the market value of the assets of the plan that is not the ongoing plan (that become part of the assets of the ongoing plan) on the date of the merger. The amortization charge or credit (whichever is the case) is determined for such base and is ratably adjusted to reflect the length of the interim period.

(4) The funding standard account for the ongoing plan for the plan year in which the merger occurs is determined in steps. In the first step the funding standard account for the ongoing plan is determined without regard to the merger. In the second step, the funding standard account for the plan that is not the ongoing plan is determined for the interim period by adding together the charges and credits for the first and second partial periods described in paragraph (3) above. In the third step the charges and credits from the first two steps are combined in a manner similar to the treatment for separate plans under § 413(c)(4)(A) except that the credit balance or funding deficiency for each plan at the end of the year are combined to determine an overall credit balance or funding deficiency. Schedule B of Form 5500 is filed for the ongoing plan for the plan year in which the merger occurred with the combined entries to the funding standard account as described above. The other entries on the Schedule B (e.g., lines dealing with accrued liability) should be those for the ongoing plan without regard to the merger.

(5) For the plan year following the plan year in which the merger occurs the funding method for the ongoing plan is determined in accordance with the rules in paragraphs (11), (12), and (13) of section 4.07.

(6) The deductible limit under § 404 for the plan that is not the ongoing plan for the short plan year is determined, without regard to the merger, following the procedures set forth in section 5 of Rev. Proc. 87–27. The deductible limit under § 404 for the plan that is the ongoing plan is determined for the plan year in which the merger occurs as the sum of the limit determined for the plan without regard to the merger plus the limit determined with respect to the plan that is not the ongoing plan for the interim period.

(7) The following example illustrates the application of this subsection. The facts are the same as in the example in section 4.07(16) except that the plan year of Plan B is the calendar year and the valuation date is January 1, 2001. Additional facts are that the market value of the assets of Plan A as of the valuation date of October 1, 2000, is $800,000, the market value of the assets of Plan A at the date of the merger is $820,000, and there are no disbursements expected from Plan A during this period.

(a) For Plan A, for the period from October 1, 2000, through April 1, 2001, is treated as a short plan year. The funding standard account for this period is determined as shown in section 4.07(16)(f). Thus, there is a credit balance of $4,150 as of the end of the short period.

(b) For Plan B, the minimum funding standard for the plan year beginning January 1, 2001, is determined in steps as described in paragraph (4) above.

First, the minimum funding standard is determined is determined for Plan B without regard to the merger using the January 1, 2001, actuarial valuation. Thus, the normal cost would be $8,000, the amortization charge would be $11,428, the interest on these amounts (using the 8 percent interest rate) would be $1,554, and the total charges would be $20,982. The credits (without regard to employer contributions) would be the credit balance of $19,000 plus interest (at 8 percent) of $1,520 for total credits of $20,520. Accordingly, Plan B would have a funding deficiency of $462 ($20,982 minus $20,520) if there were no employer contributions and the merger was disregarded.

Second, charges and credits are determined for Plan A for the interim period (from April 1, 2001 (the date of the merger) to December 31, 2001 (the end of the plan year of the ongoing plan in which the merger occurs)) by adding together the charges and credits for the first and second partial periods. For the first partial period, the charges consist of a normal cost of $2,574 (6/12 of $5,000 adjusted for one half years interest at 6 percent), an amortization charges of $3,572 (6/12 of $6,938, with one half years interest at 6 percent) plus interest of $275 (for the period from April 1, 2001, to December 31, 2001). The credits consist of the credit balance of $4,150 (from the Schedule B for the short plan year from October 1, 2000, to April 1, 2001) plus interest (at 6 percent for the period from April 1, 2001, to December 31, 2001) of $185 for total credits of $4,336. For the second partial period, the charges consist of a normal cost of $1,250 (3/12 of $5,000), amortization charges of $2,348 (3/12 of $6,938 plus 9/12 of $818) plus interest of $71 (which includes interest on 9/12 of $818 for the period from April 1, 2001, to December 31, 2001). As part of this calculation, an amortization base of $3,650 is established to represent the asset loss from October 1, 2000, to April 1, 2001 (determined as expected assets of $823,650 less actual assets of $820,000). The amortization charge for this base is $818. There are no amortization credits for the second partial period.

Third, the charges and credits for the first two steps are combined except that the credit balance or funding deficiency for each plan at the end of the year are combined to produce an overall credit balance or funding deficiency. Thus, the charges reported on the 2001 Schedule B for Plan B would consist of a normal cost of $11,824 ($8,000 plus $2,574 plus $1,250), amortization charges of $17,347 ($11,428 plus $3,572 plus $2,347), interest of $1,900 ($1,554 plus $275 plus $71) for total charges of $31,071. The credits reported on the 2001 Schedule B (without regard to employer contributions) would be a prior year credit balance of $23,150 ($19,000 plus $4,150), interest credits of $1,705 ($1,520 plus $185), and total credits of $24,856 . The funding deficiency reported on the 2001 Schedule B as of December 31, 2001, would be $6,216 ($462 plus $5,753) if there were no employer contributions for the plan year.

SECTION 5. GENERAL RULES RELATING TO FUNDING METHODS

Approval for a change to any method in this revenue procedure does not apply unless the provisions of sections .01 through .03 are satisfied.

.01 Amortization Bases.

(1) Continued Maintenance of Waiver, Shortfall, Five-Year Alternative Switchback, and Transition Bases. In the case of a plan which, prior to a change in funding method, has a funding waiver base described in § 412(b)(2)(C), a base due to a switchback to the regular funding standard account described in § 412(b)(2)(D), a shortfall base described in § 1.412(c)(1)–2(g), or a transition base described in § 1.412(c)(3)–2(d), the current funding method, regardless of any other characteristics, must maintain such base(s) as if the funding method had not changed and must charge, or credit, the funding standard account with the amortization charge(s), or credit(s), for such base(s) after the change in funding method.

(2) Creation of a Funding Method Change Base. Except in the case of a change to a funding method described in section 3.02, section 3.03, section 3.04, or section 3.05, all existing bases shall be maintained and an amortization base shall be established equal to the difference between the unfunded accrued liability under the new method and an amount equal to (A) the net sum of the outstanding balances of all amortization bases (including, when the preceding method was an immediate gain method, the gain or loss base for the immediately preceding period), treating credit bases as negative bases, less (B) the credit balance (or plus the funding deficiency), if any, in the funding standard account, less (C) the sum of (i) any existing accumulation of additional funding charges for prior plan years due to § 412(l), (ii) any existing accumulation of additional interest charges due to late or unpaid quarterly installments for prior plan years and (iii) any existing accumulation of additional interest charges due to the amortization of prior funding waivers (which sum can be found on the Schedule B, for example, in 1997 on Line 9q(4)), all adjusted for interest at the valuation rate to the valuation date in the plan year for which the change is made. If this difference is a positive or negative number, the resulting base will be a charge base or a credit base, respectively. In the case of a change to a funding method described in section 3.02, section 3.03, section 3.04, or section 3.05, (a) the bases described in paragraph (1) must be maintained, and (b) all amortization bases other than those described in paragraph (1) shall be considered fully amortized.

(3) Amortization Period. For any charge or credit base established pursuant to the requirements of paragraph (2), the amortization period is 10 years.

(4) No base is established due solely to a change in valuation date.

.02 Although compensation must be limited in accordance with § 401(a)(17) in determining benefits to be valued, it may or may not be so limited in determining the present value of future compensation expected to be paid to the participant for each year of the participant's anticipated future service. However, the alternative used is part of the method and any change in such practice is a change in funding method.

.03 Whenever, under the funding method, the normal cost is calculated as a level percentage of compensation, then an individual's compensation is included in the amount of current year's compensation to which the normal cost percentage is applied if and only if the compensation for that individual is included in the present value of future compensation over which normal costs are spread. Similarly, whenever the normal cost is calculated as a level dollar amount, then an individual is included in the determination of the number of individuals by which the normal cost per participant is multiplied if and only if that individual is included for purposes of determining the present value of an annuity of $1 for years of anticipated service over which normal costs are spread.

SECTION 6. RESTRICTIONS UNDER REVENUE PROCEDURE

.01 General Restrictions.

(1) This revenue procedure does not apply to a change in funding method for a plan year if either (a) a Schedule B of Form 5500 has been filed for such plan year using some other funding method or (b) the due date (including extensions) for such Schedule B has passed.

(2) This revenue procedure does not apply unless the plan administrator (within the meaning of § 414(g)) or an authorized representative of the plan sponsor indicates as part of the series Form 5500 for the plan year for which the change is effective that the plan administrator or plan sponsor agrees to the change in funding method. In the case of a special approval for a change in funding method described in section 4, other than the approval described in section 4.02 (Approval for Change in Funding Method for Fully Funded Terminated Plans), the requirement that the plan administrator or authorized representative of the plan sponsor agree to the change will be satisfied if the plan administrator or an authorized representative of the plan sponsor is made aware of the change before the Schedule B is filed.

(3) This revenue procedure does not apply if, for the plan year of the change, a minimum funding waiver under § 412(d) has been requested for the plan or is being amortized, or if an extension of an amortization period under § 412(e) has been requested or is currently applicable for computing minimum funding requirements, for the plan.

(4) This revenue procedure does not apply if the plan is under an Employee Plans examination for any plan year, or if the plan sponsor, or a representative, has received verbal or written notification from the Tax Exempt and Government Entities Division of an impending Employee Plans examination, or of an impending referral from another part of the Service for an Employee Plans examination, or if the plan has been under such an examination and is in Appeals or in litigation for issues raised in an Employee Plans examination.

(5) Except as provided in section 4.02, this revenue procedure does not apply to a change which is made for a plan year in which the plan is terminated.

(6) Non-Applicability if Shortfall Method is Discontinued. If the current method makes use of the shortfall method, approval to change to another funding method under this revenue procedure will apply only if the new funding method continues to make use of the shortfall method. For example, approval is not granted to change from the entry age normal method (which uses the shortfall method) to the unit credit method under section 3.01 unless the unit credit method makes use of the shortfall method.

.02 Additional Restrictions For Approvals in Section 3.

(1) Non-Applicability for Reversion Cases. This revenue procedure does not apply to changes in funding method required by Treasury Release R-2697 dated May 24, 1984, concerning the reversion of assets from a terminated plan. Furthermore, approval under section 3 does not apply if, in the 15 years preceding the date of change, such plan was involved in a transaction described in such Treasury Release subsequent to May 24, 1984.

(2) Non-Applicability for Plans Using Universal Life Insurance Products. Approval to change to a method described in section 3 does not apply in the case of a plan for which some of the assets are provided through universal life insurance policies unless, under the funding method adopted, (a) all plan benefits including those provided by the universal life insurance policies are considered liabilities in calculating costs and are funded using the same method as used for retirement costs, and (b) the cash value as of the valuation date of such contracts is treated the same as all other assets of the plan in calculating costs. However, the requirements of (a) above will not fail to be satisfied merely because ancillary benefits, within the meaning of § 1.412(c)(3)–1(f)(2) of the regulations, are funded on a reasonable one-year term funding method.

(3) Four-Year Limitation on Changes. Approval to change to a method described in section 3 does not apply to any of the following changes:

(a) the asset valuation method is being changed and the asset valuation method was changed in any of the four (4) preceding plan years,

(b) the valuation date is being changed and the valuation date was changed in any of the four (4) preceding plan years, or

(c) The funding method is being changed in a way not described in (a) or (b), and a funding method change (other than a change for which approval is provided by section 4 of this revenue procedure, or a change described in (a) or (b)) was made in any of the four (4) preceding plan years.

(4) Non-Applicability when Liabilities are Adjusted for Assets. Approval to change to a method described in section 3 does not apply to a change in funding method under which the liabilities are adjusted to reflect the performance or expected performance of the assets.

(5) Non-Applicability if Benefit Accruals are Frozen Under the Plan. Approval to change to any method described in sections 3.02 through 3.09, does not apply if a plan provides that no participant may accrue a benefit as of a date that is no later than the first day of the plan year. In such a case, approval to change to the method described in section 3.01 applies only as described in section 4.01(5).

(6) Non-Applicability if Negative Normal Cost or Negative Unfunded Liability Results From the Change. Approval to change to a method described in section 3 does not apply if, after the change in method, a negative normal cost exists. Also, approval to change to a method described in section 3 does not apply if, after the change in method, a negative unfunded liability exists, and the method (a) is a spread gain method, and (b) uses an unfunded liability in determining the normal cost. For purposes of the preceding sentence, a spread gain method is any method that does not directly calculate an accrued liability. See Rev. Rul. 81–13 for whether a funding method directly calculates an accrued liability.

(7) Non-Applicability if Change in Method is Being Made Pursuant to a Spin-off or Merger. Approval to change to a method described in section 3 does not apply if the funding method for a plan year is being changed in connection with a plan spin-off or merger unless the change is made as provided in section 4.05, section 4.06, section 4.07, or section 4.08.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for plan years commencing on or after January 1, 2000.

SECTION 8. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 95–51, as clarified and modified by Rev. Proc. 98–10 and Rev. Proc. 99–45, is superseded.

DRAFTING INFORMATION

The principal author of this revenue procedure is James E. Holland, Jr. of the Tax Exempt and Government Entities Division. For further information regarding this revenue procedure, call (202) 622-6076 between 2:30 and 3:30 Eastern time (not a toll free number) Monday through Friday. Mr. Holland’s number is (202) 622-6730 (also not a toll free number).