

§ 1.404(a)-4

26 CFR Ch. I (4-1-04 Edition)

(d) Any expenses incurred by the employer in connection with the plan, such as trustee's and actuary's fees, which are not provided for by contributions under the plan are deductible by the employer under section 162 (relating to trade or business expenses), or 212 (relating to expenses for production of income) to the extent that they are ordinary and necessary.

(e) In case deductions are allowable under section 404(a)(3), as well as under section 404(a) (1) or (2), the limitations under section 404(a) (1) and (3) are determined and applied without giving effect to the provisions of section 404(a)(7) but the amounts allowable as deductions are subject to the further limitations provided in section 404(a)(7). See § 1.404(a)-13.

(f)(1) Amounts contributed by an employer under the plan for the funding of medical benefits described in section 401(h) as defined in paragraph (a) of § 1.401-14 must satisfy the general requirements which are applicable to deductions allowable under section 404 and which are set forth in § 1.404(a)-1 including, for example, the requirements described in paragraph (b) of such section. Accordingly, such amounts must constitute an ordinary and necessary expense relating to either the trade or business or the production of income and must not, when added to all other compensation paid by the employer to the employee on whose behalf such a contribution is made, constitute more than reasonable compensation. However, in determining the amount which is deductible with respect to contributions to provide retirement benefits under the plan, amounts contributed for the funding of medical benefits described in section 401(h) shall not be taken into consideration.

(2) The amounts deductible with respect to employer contributions to fund medical benefits described in section 401(h) shall not exceed the total cost of providing such benefits. The total cost of providing such benefits shall be determined in accordance with any generally accepted actuarial method which is reasonable in view of the provisions and coverage of the plan, the funding medium, and other applicable considerations. The amount deduct-

ible for any taxable year with respect to such cost shall not exceed the greater of—

(i) An amount determined by distributing the remaining unfunded costs of past and current service credits as a level amount, or as a level percentage of compensation, over the remaining future service of each employee, or

(ii) 10 percent of the cost which would be required to completely fund or purchase such medical benefits.

In determining the amount deductible, an employer must apply either subdivision (i) of this subparagraph for all employees or subdivision (ii) of this subparagraph for all employees. If contributions paid by an employer in a taxable year to fund such medical benefits under a pension or annuity plan exceed the limitations of this subparagraph but otherwise satisfy the conditions for deduction under section 404, then the excess contributions are carried over and are deductible in succeeding taxable years of the employer which end with or within taxable years of the trust for which it is exempt under section 501(a) in order of time to the extent of the difference between the amount paid and deductible in each succeeding year and the limitation applicable to such year under this subparagraph. For purposes of subdivision (i) of this subparagraph, if the remaining future service of an employee is one year or less, it shall be treated as one year.

[T.D. 6500, 25 FR 11685, Nov. 26, 1960, as amended by T.D. 6722, 29 FR 5073, Apr. 14, 1964; T.D. 7165, 37 FR 5025, Mar. 9, 1972]

§ 1.404(a)-4 Pension and annuity plans; limitations under section 404(a)(1)(A).

(a) Subject to the applicable general conditions and limitations (see § 1.404(a)-3), the initial limitation under section 404(a)(1)(A) is 5 percent of the compensation otherwise paid or accrued during the taxable year to all employees under the pension or annuity plan. This initial 5-percent limitation applies to the first taxable year for which a deduction is allowed for contributions to or under such a plan and also applies to any subsequent year (other than one described in paragraph

(d) of this section) for which the 5-percent figure is not reduced as provided in this section. For years to which the initial 5-percent limitation applies, no adjustment on account of prior experience is required. If the contributions do not exceed the initial 5-percent limitation in the first taxable year to which this limitation applies, the taxpayer need not submit actuarial data for such year.

(b) For the first taxable year following the first year to which the initial 5-percent limitation applies, and for every fifth year thereafter, or more frequently where preferable to the taxpayer, the taxpayer shall submit with his return an actuarial certification of the amount reasonably necessary to provide the remaining unfunded cost of past and current service credits of all employees under the plan with a statement explaining all the methods, factors, and assumptions used in determining such amount. This amount may be determined as the sum of (1) the unfunded past service cost as of the beginning of the year, and (2) the normal cost for the year. Such costs shall be determined by methods, factors, and assumptions appropriate as a basis of limitations under section 404(a)(1)(C). Whenever requested by the district director, a similar certification and statement shall be submitted for the year or years specified in such request. The district director will make periodical examinations of such data at not less than 5-year intervals. Based upon such examinations the Commissioner will reduce the limitation under section 404(a)(1)(A) below the 5-percent limitation for the years with respect to which he finds that the 5-percent limitation exceeds the amount reasonably necessary to provide the remaining unfunded cost of past and current service credits of all employees under the plan. Where the limitation is so reduced, the reduced limitation shall apply until the Commissioner finds that a subsequent actuarial valuation shows a change to be necessary. Such subsequent valuation may be made by the taxpayer at any time and submitted to the district director with a request for a change in the limitation. See, however, paragraph (d) of this section with respect to taxable years to which the

limitation under section 404(a)(1)(A) does not apply.

(c) For the purpose of limitations under section 404(a)(1)(A), "compensation otherwise paid or accrued" means all of the compensation paid or accrued except that for which a deduction is allowable under a plan that qualifies under section 401(a), including a plan that qualifies under section 404(a)(2). Where two or more pension or annuity plans cover the same employee, under section 404(a)(1)(A) the deductions with respect to each such plan are subject to the limitations applicable to the particular plan and the total deductions for all such plans are also subject to the limitations which would be applicable thereto if they constituted a single plan. Where, because of the particular provisions applicable to a large class of employees under a plan, the costs with respect to such employees are nominal in comparison with their compensation, after the first year to which the initial 5-percent limitation applies, deductions under section 404(a)(1)(A) are subject to limitations determined by considering the plan applicable to such class as if it were a separate plan. Deductions are allowable to the extent of the applicable limitations under section 404(a)(1)(A) even where these are greater than the applicable limitations under section 404(a)(1)(B) or section 404(a)(1)(C).

(d) The limitation under section 404(a)(1)(A) shall not be used for purposes of determining the amount deductible for a taxable year of the employer which ends with or within a taxable year of the pension trust during which it is not exempt under section 501(a), or, in the case of an annuity plan, during which it does not meet the requirements of section 404(a)(2), or which ends after the trust or plan has terminated. See § 1.404(a)-7 for rules relating to the limitation which is applicable for purposes of determining the amount deductible for such a taxable year of the employer.

[T.D. 6500, 25 FR 11685, Nov. 26, 1960, as amended by T.D. 6534, 26 FR 515, Jan. 20, 1961]