[2] Exclusions. Public utility property is excluded from each of the following categories of energy property:
(i) Alternative energy property.
(ii) Specially defined energy property.
(iii) Solar or wind energy property.
(iv) Recycling equipment.

[3] Public utility property. The term "public utility property" has the meaning given in section 46(f)(5).

"Public utility property" has the meaning given in section 46(f)(5). [FR Doc. 81-2467 Filed 1-19-81; 5:10 pm]

William E. Williams,
Acting Commissioner of Internal Revenue.

Approved: January 19, 1981.

Emil M. Sunley,
Acting Assistant Secretary of the Treasury.

FOR FURTHER INFORMATION CONTACT:

SALARY OF EMPLOYEE ROLLOVERS

The final regulations also contain two additional clarifying rules governing the estate tax exclusion for amounts payable under individual retirement plans. The first of these rules reflects section 1408-2(b)(7)(ii) of the Income Tax Regulations. That section permits a beneficiary under an individual retirement plan to elect, for purposes of the income tax rules, to treat the plan as one established on the beneficiary's behalf, rather than as a plan under which amounts are payable to the beneficiary as a beneficiary. Under section 20.2039-5(c)(5), the amount with respect to which the decedent, as a beneficiary, made the election is not an amount with respect to which the exclusion described in section 2039(f) will apply.

The final regulations also contain, in section 20.2039-5(c)(6), rules relating to individual retirement plan rollovers. Under section 408(d)(3)(A)(i) or 409(b)(3)(C), amounts paid under an individual retirement plan may, subject to certain conditions, be paid "rolled over" to another such plan. Under the income tax rules, the rolled over amounts are not included in gross income. The final regulations clarify that the rules under section 2039(e) are applied to the plan that is the recipient of the rollover (the "transferee plan") by taking into account the source of the contributions made to the transferee plan. Under the regulations the exclusion described in section 2039(e) does not apply with respect to any portion of the rollover contribution to the transferee plan that is determined to be attributable to a contribution to the transferor plan with respect to which the exclusion is denied.

Examples [3] and [4] have been added to section 20.2039-5(d) to illustrate these added clarifying rules.

IRA Provisions Added

The final regulations also contain a second clarifying rule governing the estate tax exclusion for amounts payable under individual retirement plans. The first of these rules reflects section 1408-2(b)(7)(ii) of the Income Tax Regulations. That section permits a beneficiary under an individual retirement plan to elect, for purposes of the income tax rules, to treat the plan as one established on the beneficiary's behalf, rather than as a plan under which amounts are payable to the beneficiary as a beneficiary. Under section 20.2039-5(c)(5), the amount with respect to which the decedent, as a beneficiary, made the election is not an amount with respect to which the exclusion described in section 2039(f) will apply.

The final regulations also contain, in section 20.2039-5(c)(6), rules relating to individual retirement plan rollovers. Under section 408(d)(3)(A)(i) or 409(b)(3)(C), amounts paid under an individual retirement plan may, subject to certain conditions, be paid "rolled over" to another such plan. Under the income tax rules, the rolled over amounts are not included in gross income. The final regulations clarify that the rules under section 2039(e) are applied to the plan that is the recipient of the rollover (the "transferee plan") by taking into account the source of the contributions made to the transferee plan. Under the regulations the exclusion described in section 2039(e) does not apply with respect to any portion of the rollover contribution to the transferee plan that is determined to be attributable to a contribution to the transferor plan with respect to which the exclusion is denied.

Examples [3] and [4] have been added to section 20.2039-5(d) to illustrate these added clarifying rules.

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The final regulations also contain, in section 20.2039-5(c)(6), rules relating to individual retirement plan rollovers. Under section 408(d)(3)(A)(i) or 409(b)(3)(C), amounts paid under an individual retirement plan may, subject to certain conditions, be paid "rolled over" to another such plan. Under the income tax rules, the rolled over amounts are not included in gross income. The final regulations clarify that the rules under section 2039(e) are applied to the plan that is the recipient of the rollover (the "transferee plan") by taking into account the source of the contributions made to the transferee plan. Under the regulations the exclusion described in section 2039(e) does not apply with respect to any portion of the rollover contribution to the transferee plan that is determined to be attributable to a contribution to the transferor plan with respect to which the exclusion is denied.

Examples [3] and [4] have been added to section 20.2039-5(d) to illustrate these added clarifying rules.
Community Property Interests in IRA's

Several persons commenting on the proposed regulations raised questions with regard to the treatment of a decedent's community property interest in an IRA.

Section 2039 does not include rules specifically governing the treatment of community property interests in individual retirement plans. Community property interests are the subject of section 2039(d), but that section by its terms applies only to community property interests in a qualified employee plan or certain annuity contracts. Subject to certain limitations, if the non-employee spouse predeceases the employee spouse, the decedent spouse's community interest under the qualified plan or contract is excluded from the gross estate.

Some commenters urged that the final regulations include a parallel rule for IRA's. The final regulations do not include such a broad rule. Absent statutory authority in subsection (d) or (e) of section 2039, a rule like that in subsection (d) cannot be applied to the predeceased spouse's community interest in an individual retirement plan. This does not mean that the exclusion is therefore denied. The community interest of the predeceased spouse is excludable as described in section 2039(e), provided that the qualifying annuity rule in § 20.2039-5(b) is satisfied with respect to that interest.

Employer Securities

The Technical Corrections Act of 1979 amended Code section 2339(f) to provide that a recipient's election under that section does not preclude the application of Code section 402(e)(4)(J) to the recipient's lump sum distribution. In general, the application of Code section 402(e)(4)(J) provides that the non-realized appreciation in employer securities received in a lump sum distribution is excludable from the recipient's gross income for the year of receipt.

Clarifying Revisions

In addition to the revisions described above, the final regulations include certain descriptive and clarifying changes. In particular, the discussion of the treatment of annuity contracts purchased for and distributed to a decedent's beneficiary under either a qualified plan or an individual retirement plan has been expanded. The example in the proposed regulations relating to individual retirement plans has also been expanded. With regard to distributions under qualified employee plans, this document revises two examples under § 20.2039-2 that were not proposed to be amended in the notice of proposed rulemaking.

Drafting Information

The principal author of this regulation is Richard L. Johnson of the Employee Plans and Benefits Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both in matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the proposed amendments to 26 CFR Parts 20 and 25 are adopted subject to the changes indicated below.

Estate Tax Regulations

(26 CFR Part 20)

Paragraph 1. Paragraph (b) of § 20.2039-2 is amended by revising Examples (2) and (3) to read as follows:

§ 20.2039-2 Annuities under "qualified plans" and section 403(b) annuity contracts.

(b) Plans and annuity contracts to which section 2039(c) applies.

Example 2. Pursuant to a profit-sharing plan, the employer made contributions to a trust which were allocated to the employee's individual account. Under the plan, the employee would, upon retirement at age 60, receive a distribution of the entire amount credited to the account. If the employee should die before reaching retirement age, the amount credited to the account would be distributed to the employee's designated beneficiary. Assume that the employee died before reaching the retirement age and that at such time the plan met the requirements of section 401(a). Since the payment to the designated beneficiary is receivable under a qualified pension plan, the provisions of section 2039(c) apply. However, if the payment is a lump sum distribution to which § 20.2039-3 or § 20.2039-4 applies, the payment is excludable from decedent's gross estate only as provided in such section. It should be noted that for purposes of the exclusion under section 2039(c) it is immaterial whether or not the payment constitutes the proceeds of life insurance under the principles set forth in § 20.2039-7(a).

Par. 2. Paragraph (c)(1) of § 20.2039-2, as set forth in the notice of proposed rulemaking, is amended by revising subdivisions (ii) and (iii) to read as follows:

§ 20.2039-2 Annuities under "qualified plans" and section 403(b) annuity contracts.

(c) Amounts excludable from the gross estate.

(1) * * *

(ii) In the case of a decedent dying before January 1, 1977, payments or contributions made under a plan described in paragraph (b) [1], [2] or [5] of this section on behalf of the decedent for a period for which the decedent was self-employed, within the meaning of section 401(c)(1), with respect to the plan are considered payments or contributions made by the decedent and not by the employer.

(iii) In the case of a decedent dying after December 31, 1976, however, payments or contributions made under a plan described in paragraph (b) [1], [2] or [5] of this section on behalf of the decedent for a period for which the decedent was self-employed, within the meaning of section 401(c)(1), with respect to the plan are considered payments or contributions made by the employer to the extent the payments or contributions are, or were, deductible under section 404 or 409(c).

Contributions or payments attributable to that period which are not, or were not, so deductible are considered made by the decedent.

Par. 3. Section 20.2039-3, as set forth in the notice of proposed rulemaking, is amended by revising the second sentence in paragraph (a) and the second sentence in paragraph (b). Paragraph (a), as revised, and the revised sentence in paragraph (b) read as follows:

[Further text not shown]

(a) Limitation of section 2039(c) exclusion. This section applies in the case of a decedent dying after December 31, 1976, and before January 1, 1979. If a lump sum distribution is paid with respect to the decedent under a plan described in paragraphs (b)(1) or (2) of a “qualified plan,” no amount paid with respect to the decedent under the plan is excludable from the decedent’s gross estate under § 20.2039-2.

(b) “Lump sum distribution” defined. The distribution of an annuity contract is not a lump sum distribution for purposes of this section, and § 20.2039-2 will apply with respect to the distribution of an annuity contract without regard to whether the contract is included in a distribution that is otherwise a lump sum distribution under this paragraph (b). * * *

Par. 4. Section 20.2039-4, as set forth in the notice of proposed rulemaking, is amended by revising the second sentence in paragraph (a), by revising paragraphs (b), (c) and (d), by redesignating paragraphs (e) and (f) as paragraphs (f) and (g), by adding a new paragraph (e), and by deleting paragraph (g). As revised, § 20.2039-4 reads as follows:


(a) Limitation on section 2039(c) exclusion. This section applies in the case of a decedent dying after December 31, 1976, if a lump sum distribution is paid or payable with respect to a decedent under a plan described in § 20.2039-2(b)(1) or (2) (a “qualified plan”), no amount paid or payable with respect to the decedent under the plan is excludable from the decedent’s gross estate under § 20.2039-2, unless the recipient of the distribution makes the section 402(a)/403(a) taxation election described in paragraph (c) of this section. For purposes of this section, an amount is payable as a lump sum distribution under a plan if, as of the date the estate tax return is filed (as determined under § 20.2039-3(d)), it is payable as a lump sum distribution at the election of the recipient or otherwise.

(b) ”Lump sum distribution” defined; treatment of annuity contracts. For purposes of this section the term ”lump sum distribution” means a lump sum distribution defined in section 402(e)(4)(A) that satisfies the requirements of section 402(e)(4)(C), relating to the aggregation of certain trusts and plans. A distribution is a lump sum distribution for purposes of this section without regard to the election described in section 402(e)(4)(B). The distribution of an annuity contract is not a lump sum distribution for purposes of this section, and the limitation described in this section does not apply to an annuity contract distributed under a plan. Accordingly, if the amount payable with respect to a decedent under a plan is paid to a recipient partly by the distribution of an annuity contract, and partly by the distribution of an amount that is a lump sum distribution within the meaning of this paragraph (b), § 20.2039-2 shall apply with respect to the annuity contract without regard to whether the recipient makes the section 402(a)/403(a) taxation election with respect to the remainder of the distribution.

(c) Recipient’s section 402(a)/403(a) taxation election. The section 402(a)/403(a) taxation election is the election by the recipient of a lump sum distribution to treat the distribution as—

(1) Taxable under section 402(a), without regard to section 402(a)(2), to the extent includable in gross income (in the case of a distribution under a qualified plan described in § 20.2039-2(b)(1)).

(2) Taxable under section 403(a), without regard to section 403(a)(2), to the extent includable in gross income (in the case of a distribution under a qualified annuity contract described in § 20.2039-2(b)(2)).

(3) A rollover contribution, in whole or in part, under section 402(a)(7) (relating to rollovers by a decedent’s surviving spouse).

Accordingly, if a recipient makes the election, no portion of the distribution is taxable to the recipient under the 10-year averaging provisions of section 402(e) or as long-term capital gain under section 402(a)(2). However, a recipient’s election under this paragraph (c) does not preclude the application of section 402(e)(4)(J) to any securities of the employer corporation included in the distribution.

(d) Method of election. The recipient of a lump sum distribution shall make the section 402(a)/403(a) taxation election by—

(1) Determining the income tax liability on the income tax return (or amended return) for the taxable year of the distribution in a manner consistent with paragraph (c)(1) or (2) of this section, or

(2) Rolling over all or any part of the distribution under section 402(a)(7).

If the date the estate tax return is filed precedes the date on which the recipient makes the section 402(a)/403(a) taxation election with respect to a lump sum distribution, the estate tax return may nevertheless reflect the election, as if the election had been made.

(e) Election irrevocable. If a recipient of a lump sum distribution files an income tax return (or amended return) or makes a rollover contribution that constitutes the section 402(a)/403(a) taxation election described in paragraphs (c) and (d), the election may not be revoked. Accordingly, a subsequent and amended income tax return filed by the recipient that is inconsistent with the prior election will not be given effect for purposes of section 2039 and section 402 or 403.

(f) Lump sum distribution to multiple recipients. In the case of a lump sum distribution paid or payable under a qualified plan, a distribution to the decedent to more than one recipient, the exclusion under § 20.2039-2 applies to so much of the distribution as is paid or payable to a recipient who makes the section 402(a)/403(a) taxation election.

(g) Distributions of annuity contracts included multiple distributions. Notwithstanding that a recipient makes the section 402(a)/403(a) taxation election with respect to a lump sum distribution that includes the distribution of an annuity contract, the distribution of an annuity contract is to be taken into account by the recipient for purposes of the multiple distribution rules under section 402(e).

Par. 5. All following paragraph (a) in § 20.2039-5, as set forth in the notice of proposed rulemaking, is revised to read as follows:

§ 20.2039-5 Annuities under individual retirement plans.

(b) Qualifying annuity. For purposes of this section, the term “qualifying annuity” means an annuity contract or other arrangement providing for a series of substantially equal periodic payments to be made to a beneficiary for the beneficiary’s life or over a period ending at least 56 months after the decedent’s death. The term “annuity contract” includes an annuity purchased for a beneficiary and distributed to the beneficiary, if under section 408 the contract is not included in the gross income of the beneficiary upon distribution. The term “other arrangement” includes any arrangement arising by reason of the decedent’s participation in the program providing the individual retirement plan. Payments shall be considered “periodic” if under the arrangement or contract (including a
intervals. If the contract or arrangement provides optional payment provisions, not all of which provide for periodic payments, payments shall be considered periodic only if an option providing periodic payments is elected not later than the date the estate tax return is filed (as determined under §20.2039-3(d)). For this purpose, the right to surrender a contract (including a distributed contract) for a cash surrender value will not be considered an optional payment provision. Payments shall be considered "substantially equal" even though the amounts receivable by the beneficiary may vary. Payments shall not be considered substantially equal, however, if more than 40 percent of the total amount payable to the beneficiary under the individual retirement plan, determined as of the date of the decedent's death and excluding any postmortem increase, is payable to the beneficiary in any 12-month period.

(c) *Amount excludable from gross estate—(1) in general.* Except as otherwise described in this paragraph, the amount excluded from the decedent's gross estate under section 2039(e) is the entire value of the qualifying annuity (as determined under §§20.2031-1 and 20.2031-7 through 20.2031-10) payable under the individual retirement plan.

(2) *Excess contribution.* In any case in which there exists, on the date of the decedent's death, an excess contribution (as defined in section 4973(b)) with respect to the individual retirement plan, the amount excluded from the value of the decedent's gross estate is determined under the following formula:

\[ E = A - (X + C - R) \]

Where:
- \( E \) = the amount excluded from the decedent's gross estate under section 2039(e).
- \( A \) = the value of the qualifying annuity at the decedent's death (as determined under §§20.2031-1 and 20.2031-7 through 20.2031-10).
- \( X \) = the amount which is an excess contribution at the decedent's death (as determined under section 4973(b)).
- \( C \) = the total amount contributed by or on behalf of the decedent to the individual retirement plan, and
- \( R \) = the total amount paid or distributed from the individual retirement plan before the death of the decedent which were either includable in the gross income of the recipient under section 408(d)(1) and represented the payment or distribution of an excess contribution, or were payments or distributions described in section 403(b)(4) or (5) (relating to returned excess contributions).

(3) *Certain section 408(b)(8) rollover contributions.* This subparagraph (3) applies if the decedent made a rollover contribution to the individual retirement plan under section 403(b)(8), and the contribution was attributable to a distribution under an annuity contract other than an annuity contract described in §20.2039-2(b)(3). If such a rollover contribution was the only contribution made to the plan, no part of the value of the qualifying annuity payable under the plan is excluded from the decedent's gross estate under section 2039(e). If a contribution other than such a rollover contribution was made to the plan, the amount excluded from the decedent's gross estate is determined under the formula described in subparagraph (2) of this paragraph, except that for purposes of that formula, \( X \) includes the amount that was a rollover contribution under section 403(b)(8) attributable to a distribution under an annuity contract not described in §20.2039-2(b)(3).

(4) *Surviving spouse's rollover contribution.* This subparagraph (4) applies if the decedent made a rollover contribution to the individual retirement plan under section 402(a)(7), relating to rollovers by a surviving spouse. If the rollover contribution under section 402(a)(7) was the only contribution made by the decedent to the plan, no part of the value of the qualifying annuity payable under the plan is excluded from the decedent's gross estate under section 2039(e). If a contribution other than a rollover contribution under section 402(a)(7) was made by the decedent to the plan, the amount excluded from the decedent's gross estate is determined under the formula described in subparagraph (2) of this paragraph, except that for purposes of that formula, \( X \) includes the amount that was a rollover contribution under section 402(a)(7).

(5) *Election under §1.408-2(b)(7)(ii).* This subparagraph (5) applies if the decedent at any time made the election described in §1.408-2(b)(7)(ii) with respect to an amount in the individual retirement plan. If this subparagraph (5) applies, the amount excluded from the decedent's gross estate under section 2039(e) is the entire value of the plan. If the decedent made a rollover contribution to the plan, the amount excluded from the decedent's gross estate under section 2039(e) is the entire value of the plan.

(6) *Plan-to-plan rollovers.* (i) This subparagraph (6) applies if the individual retirement plan to which the rollover described in this subparagraph (6)(i) was a rollover from one individual retirement plan to another made by the decedent. The amount of the contribution described in section 408(d)(3)(A)(i) or 408(b)(3)(C) is the "rollover amount." The plan from which the rollover amount was paid or distributed to the decedent is the "transferor plan.

(ii) If the decedent made a contribution described in subparagraph (3) or (4) to the transferor plan, the amount excluded from the decedent's gross estate with respect to the transferee plan is determined under the formula described in subparagraph (2), except that for purposes of that formula, \( X \) includes so much of the rollover amount as was attributable to the contribution to the transferee plan that was described in subparagraph (3) or (4). The extent to which a rollover amount is attributable to a contribution described in subparagraph (3) or (4) that was made to the transferee plan is determined by multiplying the rollover amount by a fraction, the numerator of which is the amount of such contribution, and the denominator of which is the sum of all amounts contributed by the decedent to the transferee plan (if not returned as described under R in subparagraph (2)), and any amount in the transferee plan to which the election described in subparagraph (5) applied.

(iii) If the decedent made the election described in subparagraph (5) with respect to an amount in the transferee plan, the amount excluded from the decedent's gross estate with respect to the transferee plan is determined under the formula described in subparagraph (2), except that for purposes of that formula, \( X \) includes so much of the rollover amount as was attributable to the amount in the transferee plan to which the election applied. The extent to which a rollover amount is attributable to an amount in the transferee plan to which the election applied is determined by multiplying the rollover amount by a fraction, the numerator of which is the amount which to which the election applied, and the denominator of which is the sum of all amounts contributed by the decedent to the transferee plan (if not returned as described under R in subparagraph (2)), and any amount in the transferee plan to which the election applied.

(iv) If a transferor plan described in this subparagraph (6) was also a transferee plan, then the rules described in this subparagraph (6) are to be applied with respect to both the rollover amount paid to the plan and the rollover amount thereafter paid from the plan.
(d) Examples. The provisions of this section are illustrated by the following examples:

Example (1). (1) A establishes an individual retirement account described in section 408(a)(1) on January 1, 1978, which A's only contribution to the account is a rollover contribution (under section 408(a)(7)). After A's death, the balance in the IRA is $240,000. A's surviving spouse is to receive all contributions to the IRA. Under paragraph (c) of this section, the amount not excluded from F's gross estate is $139,096. 

Example (2). Assume the same facts as in example (1), except that A's surviving spouse may receive any part of the account balance. Under paragraph (c) of this section, the amount not excluded from F's gross estate is $146,467.

Example (3). F, an individual, established an individual retirement account described in section 408(a)(1), on February 6, 1981, in order to receive a $220,000 rollover contribution from a qualified plan, as described in section 402(a)(5). B dies August 14, 1981, C, an individual, is the sole beneficiary under IRA B. The amount in IRA B ($238,000) is payable to C in whole or part as C may elect. Because the amount in IRA B is payable to C by a fraction, the numerator of which is the amount not excluded from A's gross estate ($238,000) is the sum of the contributions to IRA F2 ($101,500) + ($85,000 + $5,000). Accordingly, the amount not excluded from F's gross estate is $139,096. 

Example (4). B establishes an individual retirement plan described in section 408(a)(1) on February 6, 1981, in order to receive a $220,000 rollover contribution from a qualified plan, as described in section 402(a)(5). B dies August 14, 1981, C, an individual, is the sole beneficiary under IRA B. The amount in IRA B is payable to C by a fraction, the numerator of which is the amount not excluded from A's gross estate ($238,000) is the sum of the contributions to IRA F2 ($101,500) + ($85,000 + $5,000). Accordingly, the amount not excluded from F's gross estate is $139,096. 

Example (5). The balance in an individual retirement account described in section 408(a)(1) on January 1, 1978, is $240,000. A's surviving spouse is to receive all contributions to the IRA. Under paragraph (c) of this section, the amount not excluded from F's gross estate is $146,467.

Example (6). Assume the same facts as in example (5), except that A's surviving spouse may receive any part of the account balance. Under paragraph (c) of this section, the amount not excluded from F's gross estate is $153,933.

Gift Tax Regulations

26 CFR Part 25
Par. 6. Paragraph (c)(1)(i) of §26.2517-1, as set forth in the notice of proposed rulemaking, is amended by revising subdivisions (ii) and (vi) to read as follows:

§26.2517-1 Employees' annuities.

(c) Limitation on amount includable in gross estate.

(ii) For transfers made before January 1, 1977, payments or contributions made to a plan described in paragraph (b)(1), (i), (ii) or (vi) of this section on behalf of an individual for a period for which the individual was self-employed, within the meaning of section 401(c)(1), with respect to the plan are considered payments or contributions made by the employee.

(vi) In the case of a plan described in paragraph (b)(1), (ii) or (vi) of this section, an amount includable in the gross income of an employee under section 1372(b) relating to shareholder-beneficiaries under certain plans is considered an amount paid or contributed by the employee.

This Treasury decision is issued under the authority contained in sections 2039(f)(2) and 7605 of the Internal Revenue Code of 1984 (1982 Stat. 2768).
Assistant Secretary of the Treasury

Jerome C. Lubick, Assistant Secretary of the Treasury.

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Par. 1. Section 20.2039-2(a) is revised to read as follows:

§ 20.2039-2 Annuities under “qualified plans” and section 403(b) annuity contracts.

(a) Section 2039(c) exclusion. In general, in the case of a decedent dying after December 31, 1953, the value of an annuity or other payment receivable under a plan or annuity contract described in paragraph (b) of this section is excluded from the decedent’s gross estate to the extent provided in section 2039(c). Therefore, the payment is a lump sum distribution to which § 20.2039-3 or § 20.2039-4 applies, the payment is excludable from the decedent’s gross estate only as provided in such section.

Example (4). Pursuant to a pension plan, the employer made contributions to a trust which were used by the trustees to purchase a contract from an insurance company for the benefit of an employee. The contract was to provide the employee, upon retirement at age 65, with an annuity of $100 per month for life, and to provide the employee’s designated beneficiary upon the employee’s death after retirement, with a similar annuity for life. The contract further provided that if the employee should die before reaching retirement age, a lump sum payment equal to the greater of (a) $10,000 or (b) the reserve value of the policy would be paid to the designated beneficiary in lieu of the annuity. Assume that the employee died before reaching the retirement age and that at such time the plan met the requirements of section 2039(a). Since the payment to the designated beneficiary is receivable under a qualified profit-sharing plan, the provisions of section 2039(c) apply. However, if the payment is a lump sum distribution to which § 20.2039-3 or § 20.2039-4 applies, the payment is excludable from the decedent’s gross estate only as provided in such section.

Par. 2. Section 20.2039-2(b) is amended by removing “or” at the end of subparagraph (3), by removing the period at the end of subparagraph (4) and adding in lieu thereof “or”, and by adding a new subparagraph (5) to read as follows:

§ 20.2039-2 Annuities under “qualified plans” and section 403(b) annuity contracts.

(b) Plans and annuity contracts to which section 2039(c) applies.

Par. 3. Paragraph (b) of § 20.2039-2 is amended by revising Examples (2) and (3) to read as follows:

§ 20.2039-2 Annuities under “qualified plans” and section 403(b) annuity contracts.

(b) Plans and annuity contracts to which section 2039(c) applies.

Example (2). Pursuant to a profit-sharing plan, the employer made contributions to a trust which were allocated to the employee’s individual account. Under the plan, the employee would, upon retirement at age 60, receive a distribution of the entire amount credited to the account. If the employee should die before reaching retirement age, the amount credited to the account would be distributed to the employee’s designated beneficiary. Assume that the employee died before reaching retirement age and that at such time the plan met the requirements of section 2039(a). Since the payment to the designated beneficiary is receivable under a qualified profit-sharing plan, the provisions of section 2039(c) apply. However, if the payment is a lump sum distribution to which § 20.2039-3 or § 20.2039-4 applies, the payment is excludable from the decedent’s gross estate only as provided in such section.

Example (3).

Pursuant to a pension plan, the employer made contributions to a trust which were used by the trustees to purchase a contract from an insurance company for the benefit of an employee. The contract was to provide the employee, upon retirement at age 65, with an annuity of $100 per month for life, and to provide the employee’s designated beneficiary upon the employee’s death after retirement, with a similar annuity for life. The contract further provided that if the employee should die before reaching retirement age, a lump sum payment equal to the greater of (a) $10,000 or (b) the reserve value of the policy would be paid to the designated beneficiary in lieu of the annuity. Assume that the employee died before reaching the retirement age and that at such time the plan met the requirements of section 2039(a). Since the payment to the designated beneficiary is receivable under a qualified profit-sharing plan, the provisions of section 2039(c) apply. However, if the payment is a lump sum distribution to which § 20.2039-3 or § 20.2039-4 applies, the payment is excludable from the decedent’s gross estate only as provided in such section.

Par. 4. Section 20.2039-2(c)(1) is revised to read as follows:

§ 20.2039-2 Annuities under “qualified plans” and section 403(b) annuity contracts.

(c) Amounts excludable from the gross estate. (1) The amount to be excludable from a decedent’s gross estate under section 2039(c) is an amount which bears the same ratio to the value at the decedent’s death of an annuity or other payment receivable by the beneficiary as the employer’s contribution (or a contribution made on the employer’s behalf) on the employee’s account to the plan or towards the purchase of the annuity contract bears to the total contributions made by the employer to the plan or towards the purchase of the annuity contract. In applying this ratio—

(i) Payments or contributions made by or on behalf of the employer towards the purchase of an annuity contract described in paragraph (b)(3) of this section are considered to include only such payments or contributions as are, or were, excludable from the employee’s gross income under section 403(b).

(ii) In the case of a decedent dying before January 1, 1977, payments or contributions made under a plan described in paragraph (b) (1) or (2) or (5) of this section on behalf of the decedent for a period for which the decedent was self-employed, within the meaning of section 401(c)(1), with respect to the plan are considered payments or contributions made by the employer to the extent the payments or contributions are, or were, deductible under section 404 or 406(c).

(iii) In the case of a decedent dying after December 31, 1978, payments or contributions made under a plan described in paragraph (b) (1) or (2) or (5) of this section on behalf of the decedent for a period for which the decedent was self-employed, within the meaning of section 401(c)(1), with respect to the plan are considered payments or contributions made by the employer to the extent the payments or contributions are, or were, not deductible under section 404 or 406(c).

(iv) In the case of a decedent dying before January 1, 1977, payments or contributions made under a plan described in paragraph (b) or (2) or (5) of this section on behalf of the decedent for a period for which the decedent was self-employed, within the meaning of section 401(c)(1), with respect to the plan are considered payments or contributions made by the employer to the extent the payments or contributions are, or were, deductible under section 404 or 406(c).

(v) In the case of an annuity contract described in paragraph (b)(3) of this section, a rollover contribution described in section 402(a)(5), 403(a)(4), 403(b)(9)(B) (relating to shareholder-employee beneficiaries under certain qualified plans) is considered an amount contributed by the employer.

(vi) In the case of a plan described in paragraph (b) (1) or (2) of this section, an amount includable in the gross income of an employee under section 1379(b) (relating to contributions made by the employer to the extent the payments or contributions are, or were, deductible under section 404 or 406(c)) is considered an amount contributed by the employer.

(vii) Amounts payable under paragraph (b)(4) of this section are attributable to payments or contributions made by the decedent only to the extent of amounts deposited by the decedent pursuant to section 1438 or 1452(d) of Title 10 of the United States Code.

(viii) The value at the decedent’s death of the annuity or other payment is determined under the rules of §§ 20.2031-1 and 20.2031-7 through 20.2031-10.

(a) Limitation of section 2039(c) exclusion. This section applies in the case of a decedent dying after December 31, 1978, and before January 1, 1979. If a lump sum distribution is paid with respect to the decedent under a plan described in § 20.2039-2(b)(1) or (2) (a “qualified plan”), no amount payable with respect to the decedent under the plan is excludable from the decedent’s gross estate under § 20.2039-2.

(b) “Lump sum distribution” defined. For purposes of this section the term “lump sum distribution” means a lump sum distribution defined in section 402(e)(4)(A) that satisfies the requirements of section 402(e)(4)(C), relating to the aggregation of certain trusts and plans. The distribution of an annuity contract is not a lump sum distribution for purposes of this section, and § 20.2039-2 will apply with respect to the distribution of an annuity contract without regard to whether the contract is included in a distribution that is otherwise a lump sum distribution under this paragraph (b). A distribution is a lump sum distribution for purposes of this section without regard to the election described in section 402(a)(4)(B).

(c) Amounts payable as a lump sum distribution. If, on the date the estate tax return is filed, an amount under a qualified plan is payable with respect to the decedent as a lump sum distribution (whether at the election of a beneficiary or otherwise), for purposes of this section the amount is deemed paid as a lump sum distribution no later than on such date. Accordingly, no portion of the amount payable under the plan is excludable from the value of the decedent’s gross estate under § 20.2039-2. If, however, the amount payable as a lump sum distribution is not, in fact, thereafter paid as a lump sum distribution, there shall be allowed a credit or refund of any tax paid which is attributable to treating such amount as a lump sum distribution under this paragraph. Any claim for credit or refund filed under this paragraph must be filed within the time prescribed by section 6511, and must provide satisfactory evidence that the amount originally payable as a lump sum distribution is no longer payable in such form.

(d) Filing date. For purposes of paragraph (c) of this section, “the date the estate tax return is filed” means the earlier of—

(1) The date the estate tax return is actually filed;

(2) The date nine months after the decedent’s death, plus any extension of time for filing the estate tax return granted under section 6081.


(a) Limitation on section 2039(c) exclusion. This section applies in the case of a decedent dying after December 31, 1978, if a lump sum distribution is paid or payable with respect to a decedent under a plan described in § 20.2039-2(b)(1) or (2) (a “qualified plan”), no amount paid or payable with respect to the decedent under the plan is excludable from the decedent’s gross estate under § 20.2039-2, unless the recipient of the distribution makes the section 402(a)/403(a) taxation election described in paragraph (c) of this section. For purposes of this section, an amount is payable as a lump sum distribution under a plan if, as of the date the estate tax return is filed (as determined under § 20.2039-3(d)), it is payable as a lump sum distribution at the election of the recipient or otherwise.

(b) “Lump sum distribution” defined; treatment of annuity contracts. For purposes of this section the term “lump sum distribution” means a lump sum distribution defined in section 402(a)(4)(A) that satisfies the requirements of section 402(a)(4)(C), relating to the aggregation of certain trusts and plans. A distribution is a lump sum distribution for purposes of this section without regard to the election described in section 402(a)(4)(B). The distribution of an annuity contract is not a lump sum distribution for purposes of this section, and the limitation described in this section does not apply to an annuity contract distributed under a plan. Accordingly, if the amount payable with respect to a decedent under a plan is paid to a recipient partly by the distribution of an annuity contract, and partly by the distribution of an amount that is a lump sum distribution within the meaning of this paragraph (b), § 20.2039-2 shall apply with respect to the annuity contract without regard to whether the recipient makes the section 402(a)/403(a) taxation election with respect to the remainder of the distribution.

(c) Recipient’s section 402(a)/403(a) taxation election. The section 402(a)/403(a) taxation election is the election by the recipient of a lump sum distribution to treat the distribution as—

(1) Taxable under section 402(a), without regard to section 402(a)(2), to the extent includable in gross income (in the case of a distribution under a qualified plan described in § 20.2039-2(b)(1));

(2) Taxable under section 403(a), without regard to section 403(a)(2), to the extent includable in gross income (in the case of a distribution under a qualified annuity contract described in § 20.2039-2(b)(2)); or

(3) A rollover contribution, in whole or in part, under section 402(a)(7) (relating to rollovers by a decedent’s surviving spouse).

Accordingly, if a recipient makes the election, no portion of the distribution is taxable to the recipient under the 10-year averaging provisions of section 402(e) or as long-term capital gain under section 402(a)(2). However, a recipient’s election under this paragraph (c) does not preclude the application of section 402(e)(4)(J) to any securities of the employer corporation included in the distribution.

(d) Method of election. The recipient of a lump sum distribution shall make the section 402(a)/403(a) taxation election by—

(1) Determining the income tax liability on the income tax return (or amended return) for the taxable year of the distribution in a manner consistent with paragraph (c)(1) or (2) of this section, or

(2) Rolling over all or any part of the distribution under section 402(a)(7).

If the date the estate tax return is filed precedes the date on which the recipient makes the section 402(a)/403(a) taxation election with respect to a lump sum distribution, the estate tax return may nevertheless reflect the election, as if the election had been made.

(e) Election irrevocable. If a recipient of a lump sum distribution files an income tax return (or amended return) or makes a rollover contribution that constitutes the section 402(a)/403(a) taxation election described in paragraphs (c) and (d), the election may not be revoked. Accordingly, a subsequent and amended income tax return filed by the recipient that is inconsistent with the prior election will not be given effect for purposes of section 2039 and section 402 or 403.

(f) Lump sum distribution to multiple recipients. In the case of a lump sum distribution paid or payable under a qualified plan with respect to the decedent to more than one recipient, the exclusion under § 20.2039-2 applies to so much of the distribution as is paid or payable to a recipient who makes the section 402(a)/403(a) taxation election.
§ 20.2039-5 Annuities under individual retirement plans.

(a) Section 2039(e) exclusion.—(1) In general. In the case of a decedent dying after December 31, 1976, section 2039(e) includes the distribution of any annuity contract to the extent provided in paragraph (c) of this section. For purposes of the multiple distribution rules under section 402(e), the term "individual retirement plan" means—

(i) An individual retirement account described in section 408(a).

(ii) An individual retirement annuity described in section 408(b), or

(iii) A qualified pension plan described in section 401(a).

(b) Limitations. (1) Section 2039(e) applies only with respect to the gross estate of a decedent on whose behalf the individual retirement plan was established. Accordingly, section 2039(e) does not apply with respect to the estate of a decedent who was only a beneficiary under the plan.

(ii) Section 2039(e) does not apply to an annuity receivable by or for the benefit of the decedent's estate. For the meaning of the term "receivable by or for the benefit of the decedent's estate," see § 20.2042-1(d).

(c) Qualifying annuity. For purposes of this section, the term "qualifying annuity" means an annuity contract or other arrangement providing for a series of substantially equal periodic payments to be made to a beneficiary for the beneficiary's life or over a period ending at least 36 months after the decedent's death. The term "annuity contract" includes an annuity purchased for a beneficiary and distributed to the beneficiary. If under section 408 of the contract is not included in the gross income of the beneficiary upon distribution. The term "other arrangement" includes any arrangement arising by reason of the decedent's participation in the program providing the individual retirement plan. Payments shall be considered "periodic" if under the arrangement or contract (including a distributed contract) payments are to be made to the beneficiary at regular intervals. If the contract or arrangement provides optional payment provisions, not all of which provide for periodic payments, payments shall be considered periodic only if an option providing periodic payments is elected not later than the date the estate tax return is filed (as determined under § 20.2039-3(d)). For this purpose, the right to surrender a contract (including a distributed contract) for a cash surrender value will not be considered an optional payment provision. Payments shall be considered "substantially equal" even though the amounts receivable by the beneficiary may vary. Payments shall not be considered substantially equal, however, if more than 40% of the total amount payable to the beneficiary under the individual retirement plan, determined as of the date of the decedent's death and excluding any postmortem increase, payable to the beneficiary in any 12-month period.

(d) Amount excludible from gross estate.—(1) In general. Except as otherwise described in this paragraph, the amount excluded from the decedent's gross estate under section 2039(e) is the entire value of the qualifying annuity (as determined under §§ 20.2031-1 and 20.2031-7 through 20.2031-10) payable under the individual retirement plan.

(2) Excess contribution. In any case in which there exists, on the date of the decedent's death, an excess contribution (as defined in section 4973(b)(1)) with respect to the individual retirement plan, the amount excluded from the value of the decedent's gross estate is determined under the following formula:

\[ E = A \times (X - C - R) \]

Where:

\( E \) = the amount excluded from the decedent's gross estate under section 2039(e),

\( A \) = the value of the qualifying annuity at the decedent's death (as determined under §§ 20.2031-1 and 20.2031-7 through 20.2031-10),

\( X \) = the amount which is an excess contribution at the decedent's death (as determined under section 4973(b)(1)),

\( C \) = the total amount contributed by or on behalf of the decedent to the individual retirement plan, and

\( R \) = the total of amounts paid or distributed from the individual retirement plan before the death of the decedent which were either includable in the gross income of the recipient under section 4980B(d)(1) and represented the payment of distribution of an excess contribution, or were payments or distributions described in section 4980B(d)(4) or (6) (relating to retuned excess contributions).

(3) Certain section 403(b)(8) rollover contributions. This subparagraph (3) applies if the decedent made a rollover contribution to the individual retirement plan under section 403(b)(8), and the contribution was attributable to a distribution under an annuity contract other than an annuity contract described in § 20.2039-2(b)(3). If such a rollover contribution was the only contribution made to the plan, no part of the value of the qualifying annuity payable under the plan is excluded from the decedent's gross estate under section 2039(e). If a contribution other than such a rollover contribution was made to the plan, the amount excluded from the decedent's gross estate is determined under the formula described in subparagraph (2) of this paragraph, except that for purposes of that formula, X includes the amount that was a rollover contribution under section 403(b)(8) attributable to a distribution under an annuity contract not described in § 20.2039-2(b)(3).

(4) Surviving spouse's rollover contribution. This subparagraph (4) applies if the decedent made a rollover contribution to the individual retirement plan under section 403(b)(7), relating to rolovers by a surviving spouse. If the rollover contribution under section 403(b)(7) was the only contribution made to the plan, no part of the value of the qualifying annuity payable under the plan is excluded from the decedent's gross estate under section 2039(e).

(5) Election under § 1.408-2(b)(7)(ii). This subparagraph (5) applies if the decedent at any time made the election described in § 1.408-2(b)(7)(ii) with respect to an amount in the individual retirement plan. If this subparagraph (5) applies, the amount excluded from the decedent's gross estate is determined under the formula described in subparagraph (2) of this paragraph, except that for purposes of that formula, X and C include the amount attributable to a rollover contribution under section 403(b)(7).

(6) Plan-to-plan rollovers. (i) This subparagraph (6) applies if the individual retirement plan is a transferee plan. A "transferee plan" is a plan that was the recipient of a contribution described in section 408(d)(3)(A)(ii) or 408(b)(3)(C) (relating to rollovers from one individual retirement plan to another) made by the decedent.

(ii) Certain contributions. This subparagraph (6) applies if the decedent made a rollover contribution to the individual retirement plan under section 403(b)(8), and the contribution was attributable to a distribution under an annuity contract other than an annuity contract described in § 20.2039-2(b)(3). If such a rollover contribution was the only contribution made to the plan, no part of the value of the qualifying annuity payable under the plan is excluded from the decedent's gross estate under section 2039(e). If a contribution other than such a rollover contribution was made to the plan, the amount excluded from the decedent's gross estate is determined under the formula described in subparagraph (2) of this paragraph, except that for purposes of that formula, X includes the amount that was a rollover contribution under section 403(b)(8) attributable to a distribution under an annuity contract not described in § 20.2039-2(b)(3).
409(b)(3)(C) is the "rollover amount." The plan from which the rollover amount was paid or distributed to the decedent is the "transferor plan." (ii) If the decedent made a contribution described in subparagraph (3) or (4) to the transfer plan, the amount excluded from the decedent's gross estate with respect to the transferee plan is determined under the formula described in subparagraph (2), except that for purposes of that formula, X includes so much of the rollover amount as was attributable to the contribution to the transferor plan that was described in subparagraph (3) or (4). The extent to which a rollover amount is attributable to a contribution described in subparagraph (3) or (4) that was made to the transferor plan is determined by multiplying the rollover amount by a fraction, the numerator of which is the amount of such contribution, and the denominator of which is the sum of all amounts contributed by the decedent to the transferor plan (if not returned as described under R in subparagraph (2)), and any amount in the transfer plan to which the election described in subparagraph (5) applied. (iii) If the decedent made the election described in subparagraph (5) with respect to an amount in the transferor plan, the amount excluded from the decedent's gross estate with respect to the transferee plan is determined under the formula described in subparagraph (2), except that for purposes of that formula, X includes so much of the rollover amount as was attributable to the amount in the transferor plan to which the election applied. The extent to which a rollover amount is attributable to an amount in the transferor plan to which the election is applied is determined by multiplying the rollover amount by a fraction, the numerator of which is the amount to which the election applied, and the denominator of which is the sum of all amounts contributed by the decedent to the transferor plan (if not returned as described under R in subparagraph (2)), and the amount in the transfer plan to which the election applied. (iv) If a transfer plan described in this subparagraph (6) was also a transfer plan, then the rules described in this subparagraph (6) are to be applied with respect to both the rollover amount paid to the plan and the rollover amount thereafter paid from the plan. (d) Examples. The provisions of this section are illustrated by the following examples: Example (1). (1) A establishes an individual retirement account described in section 408(a) on January 1, 1976, when A is age 65. A's only contribution to the account is a rollover contribution described in section 402(a)(5). The trust agreement provides that all A may at any time elect to have the balance in the account distributed in one of the following methods: (i) A single sum payment of the account; (ii) Equal or substantially equal semiannual payments over a period equal to A's life expectancy, or (iii) Equal or substantially equal semiannual payments over a period equal to the life expectancy of A or A's spouse. (2) The trust agreement further provides that although semiannual payments have commenced under option (ii) or (iii), A or A's surviving spouse may, by written notice to the trustee, receive all or a part of the balance remaining in the account. In addition, under option (ii), any balance remaining in the account at A's death is payable in a single sum to A's designated beneficiary. Under option (iii), any balance remaining in the account at A's death is payable in a single sum to a beneficiary designated by A or A's surviving spouse. (3) A elects option (ii), and the first semiannual payment is made to A on July 1, 1976. On that date, A's life expectancy is 15 years, and that of A's spouse is 22 years. Under option (iii), the semiannual payments payable to A or A's surviving spouse will continue until July 1, 1998. (4) A dies on November 20, 1978. On December 15, 1978, the trust agreement is modified so that A's surviving spouse no longer may elect to receive all or part of the balance remaining in the account. The value of the semiannual payments payable to A's spouse is excluded from A's gross estate under section 2039(e). (5) A's spouse dies July 12, 1981. The single sum payment payable on account of the death of A's spouse is paid to the designated beneficiary on August 1, 1981. Notwithstanding that the balance in the account was paid to the designated beneficiary within 36 months after A's death, the value of the semiannual payments payable to A's spouse are excluded from A's gross estate under section 2039(e). (6) B establishes an individual retirement account described in section 408(a) on February 6, 1981, in order to receive a $238,000 distribution on December 15, 1980, when B receives an $85,000 distribution on December 15, 1980, F's entire interest in IRA F1, $100,000, is payable to C in whole or part as C may elect. Because IRA F1 includes a rollover contribution and makes the contribution constitutes an election to qualify as a qualified trust, the balance in IRA F1 is payable to C as other than a qualifying annuity, within the meaning of paragraph (b) of this section, no amount is excluded from B's gross estate under section 2039(e). (2) On October 17, 1981, C contributes $1,500 on C's own behalf to IRA B. Under § 1.408—2(b)[7][iii], C's contribution will cause IRA B to be treated as being maintained by and on behalf of C ("IRA C") and C's making the contribution constitutes an election to which paragraph (c)[ii] of this section applies. The balance in IRA C immediately before C's contribution is $240,000. Accordingly, the amount with respect to which C made the election ($240,000—$242,000), and this section are applied with respect to the gross estate of C without regard to whether amounts now payable under IRA C were or were not excluded from B's gross estate. Under paragraph (c) of this section, the amount not excluded from C's gross estate is the value of the qualifying annuity payable to E ($242,000), multiplied by the fraction $1/$240,000 ($240,000+$1,500)=$240,497. The amount excluded is therefore $1,500 ($242,000—$240,497). Example (4). (1) F, an individual, establishes an individual retirement plan ("IRA F1") on June 1, 1979, which elects $1,250 annual contributions for 1979, 1978 and 1980 ($1,250—$1,250). Each of which is deducted by F under section 219. In February 1980, F receives an $85,000 distribution on account of the death of C. F's sole beneficiary on December 15, 1978, and under paragraph (c) of this section, the amount not excluded from C's gross estate is the value of the qualifying annuity payable to E ($242,000), multiplied by the fraction $1/$240,000 ($240,000+$1,500)=$240,497. The amount excluded is therefore $1,500 ($242,000—$240,497).
under IRA F2 multiplied by the fraction
$96,700/$101,500. Accordingly, the amount
not excluded is $139,096. [$146,000 (408(a)
$101,500) = $139,096]. The amount excluded is
$6,904 ([146,000 - 139,096]).

(iii) An annuity or other payment payable
thereunder attributable to payments or contributions made by both the employee and an employer, the
exclusion is limited to that proportion of the value of the gift (see paragraph (a)(1) of this section) of
an annuity or other payment which the employer’s contribution (or a contribution made on the employer’s
behalf) to the plan on the employee’s account bears to the total contributions to the plan on the employee’s account.

In applying this ratio—

(i) Payments or contributions made by the employer toward the purchase of an
annuity contract described in paragraph (b)(i) (iii) of this section are considered to be employer contributions to the extent that the contributions are not, or were not, excludable from the employee’s gross income under section 403(b).

(ii) For transfers made before January 1, 1977, payments or contributions made to a plan described in paragraph (b)(i) (ii), (i) or (vi) of this section on behalf of an individual for a period for which the individual was self-employed, within the meaning of section 401(e)(1), with respect to the plan are considered payments or contributions made by the employer.

(iii) For transfers made after December 31, 1976, however, payments or contributions made under a plan described in paragraph (b)(1) (i), (ii) or (vi) of this section on behalf of such a self-employed individual are considered employer contributions to the extent that they are, or were, deductible under section 404 or 408(c), and are considered employee contributions to the extent that they are not, or were not, so deductible.

(iv) In the case of a plan described in paragraph (b)(1) (i) or (ii) of this section, a rollover contribution described in section 402(a)(5), 403(a)(4), 403(d)(3)(A)(ii) or 409(b)(3)(C) is considered an amount contributed by the employer.

(v) In the case of an annuity contract described in paragraph (b)(1) (iii) of this section, a rollover contribution described in section 402(a)(5), 403(a)(4), 403(d)(3)(A)(ii) or 409(b)(3)(C) is considered an amount contributed by the employer.

(vi) In the case of a plan described in paragraph (b)(1) (i), (ii) or (vi) of this section, an includable in the gross income of an employee under section 1379(b) (relating to shareholder-beneficiaries under certain plans) is considered an amount paid or contributed by the employer.

(vii) In the case of an annuity described in paragraph (b)(1) (iv) of this section, amounts paid or contributed by the employee include only amounts deposited by the employee under section 1438 or 1452(d) of Title 10 of the United States Code.

The application of this paragraph may be illustrated by the following examples, none of which involves employees within the meaning of section 401(c)(1):

(d) Exemption of annuity interest created by community property laws—

(i) In general. An employee’s transfer of benefits attributable to either—

(ii) Contributions or payments made
by an employer or former employer on
the employee’s behalf to a trust, annuity
contract or bond purchase plan described in paragraph (b)(1) (i), (ii), (iii) or (vi) of this section, or

(iii) Contributions or payments made
by the employee to an individual
retirement plan described in paragraph (b)(1) (v) of this section, will not be considered a transfer by the employee’s spouse to the extent the spouse’s interest in the transferred benefits is also attributable to such contributions or payments and arises solely by reason of the spouse’s interest in community income under the community property laws of a State.

(2) Limitation. The exemption described in subparagraph (j) of this paragraph does not apply in the case of an employee’s transfer of benefits payable under a trust, annuity contract or bond purchase plan described in paragraph (b)(1) (i), (ii), (iii) or (vi) of this section to the extent such benefits are attributable to contributions or payments made by the employee. For purposes of the limitation described in this subparagraph—

(i) Employer contributions toward the purchase of an annuity contract described in paragraph (b)(1) (iii) of this section, to the extent not excludable from the employee’s gross income under section 403(b), are considered employee contributions.

(ii) In the case of a plan described in paragraph (b)(1) (i), (ii) or (vi) of this section, contributions or payments made by the individual while the individual was self-employed within the meaning of section 401(c)(1) with respect to the plan are considered employer contributions to the extent they are, or were, deductible under section 404 or 405(c) and are considered employee contributions to the extent they are not, or were not, so deductible.

(iii) In the case of a plan described in paragraph (b)(1) (i) or (ii) of this section, a rollover contribution described in section 402(a)(5), 403(a)(4), 403(d)(3)(A)(ii) or 409(b)(3)(C) is considered an employer contribution.
DEPARTMENT OF LABOR
Wage and Hour Division
29 CFR Part 778
Overtime Compensation

AGENCY: Wage and Hour Division, Labor.

ACTION: Amendment to Interpretable Bulletin.

SUMMARY: Part 778 explains the overtime provisions of the Fair Labor Standards Act and provides numerous examples of how these provisions apply to specific situations. It is now being revised in order to reflect amendments to the Act that have changed some of the overtime provisions. In addition, the wage rates specified in most of the examples have been increased to take account of increases in the statutory minimum wage rate. There has also been a change made to a section which deals with the effect on the overtime rate of pay of compensating for certain activities which the Act does not require an employer to pay for.

EFFECTIVE DATE: January 23, 1981.

FOR FURTHER INFORMATION CONTACT: Mr. James L. Valin, Director, Division of Minimum Wage and Hour Standards, Office of Fair Labor Standards, Wage and Hour Division, U.S. Department of Labor, 200 Constitution Avenue N.W., Rm. S-3508, Washington, D.C. 20210. Telephone: (202) 220-7943. (This is not a toll-free number.)

SUPPLEMENTARY INFORMATION: Part 778 of Title 29, Code of Federal Regulations, constitutes the official interpretations of the Department of Labor with respect to the meaning and application of the maximum hours and overtime compensation requirements contained in Section 7 of the Fair Labor Standards Act (29 U.S.C. 207). During the period since Part 778 was last revised, the Fair Labor Standards Act has been amended, not only to increase the statutory minimum wage rate, but also to repeal part of Section 7.

The statutory amendments have necessitated two types of changes in Part 778. First, the wage rates specified in nearly all of the examples have been increased, so that no pay practice described in any result in an employee being paid less than the current minimum wage. However, the principles illustrated by the example remain unchanged.

Second, the discussion of Sections 7(c) and 7(d) of the FLSA has been deleted from § 778.603, because those provisions, which partially exempted certain employees from the overtime protections of the FLSA, were repealed effective December 31, 1978, as a result of the Fair Labor Standards Amendments of 1974. In a related change, § 778.603 has been deleted because its description of the partial overtime exemptions in Sections 13(b)(8) and 13(b)(19) of the FLSA has become obsolete as a result of the Fair Labor Standards Amendments of 1974.

In addition to these changes, another revision has been made to Part 778. This revision is to § 778.320, which deals with compensation for hours spent in certain types of activities which would regarded as working time under the Act if no compensation were provided.

Examples of such activities specifically referred to in old § 778.320 were certain preliminary and post­-preliminary activities, time spent in travel outside the hours of the normal workday, and time spent in eating meals between working hours. The old section made clear that where payment for any of these activities converts them into hours worked, the payment must be added into the regular rate for purposes of determining proper overtime compensation. On the other hand, the section made clear that where payment for any of the specified activities does not convert them into hours worked, the payment can be excluded from the regular rate if the provisions of Section 7(e)(2) of the Act are satisfied. (Section 7(e)(2) excludes from the regular rate certain specified payments and “other similar payments to an employee which are not made as compensation for his hours of employment.”) Old § 778.320 very strongly implied that payment for time spent in the specified activities would almost invariably convert them into hours worked.

Although new § 778.320 retains the basic principles of the old version with regard to the effect of the extra payments on the regular rate, it makes two specific changes. The first change is to avoid the implication that payment for time spent in the specified activities converts them, virtually without exception, into hours worked. The new language expressly states that whether or not payment converts the activities into hours worked depends on

whether or not it appears from all the pertinent facts that the parties have agreed to treat such time as hours worked.” This change recognizes the fact that many employers pay for certain otherwise noncompensable activities, particularly lunch periods, in circumstances where neither the employer nor the employees intend that the time is to be hours worked. The new position more clearly honors the intent of the parties than the old position did.

The second change is to omit from the specified examples the reference to time spent in travel outside the hours of the normal workday. The inclusion of this example in old § 778.320 made that section inconsistent with § 785.39 of the Interpretive Bulletin (29 CFR § 785.39), relating to travel away from the home community. Moreover, the Department is reassessing the position taken in § 785.39 about such travel. Section 785.39 states, in pertinent part:

As an enforcement policy the Divisions will not consider as working time spent in travel away from the home community. Moreover, the Department is reassessing the position taken in § 785.39 about such travel. Section 785.39 states, in pertinent part:

Old § 778.320 was inconsistent with this position because, in referring to time spent in travel outside the hours of the normal workday, it implied that under the FLSA this time would not be considered hours worked if it was not paid for. However, § 785.39, in setting forth an enforcement position, reserves the question of whether or not such travel time is hours worked under the FLSA. The Department now has under study the issue of whether and under what circumstances the travel time referred to in § 785.39 is hours worked. Until that study has been concluded, it would not be appropriate to leave the reference to travel time in § 778.320.

Apart from the changes described above, there are also a few minor editorial changes. As this amendment involves interpretative rules, it is unnecessary to publish it initially in proposed form, or to delay the effective date beyond the date of publication of this document in the Federal Register. Nor does the Regulatory Flexibility Act apply.

It has been determined that this document does not contain a major proposal requiring the preparation of a regulatory analysis under Executive Order 12044, Improving Government Regulations (43 FR 12861, March 24, 1978).

Part 778 in its totality is a lengthy document, because it explains how the FLSA’s overtime provisions apply to virtually every pay plan that employers have devised over the years. Moreover,
in order to provide adequate guidance. Part 778 must be accurate and precise. The basic overtime principles, however, are quite simple, and the application of these principles to the most common types of pay plans—hourly wage, piece rate, salary, and commission—are set forth in a relatively short space (see §§ 778.107–122).

This document was prepared under the direction and control of Herbert J. Cohen, Assistant Administrator, Wage and Hour Division.

Accordingly, the specified sections of Part 778 are amended to read as follows.

1. The table of contents to Part 778 is amended by removing the reference to § 778.603 and by revising the titles to § 778.601 and § 778.602 as follows:

Sec. 778.601 Special overtime provisions available for hospitals and residential establishments under section 7(f).

778.602 Special overtime provisions under section 7(b).

2. Section 778.3 is revised as follows:

§ 778.3 Interpretations made, continued, and superseded by this part.

On and after publication of this part in the Federal Register, the interpretations contained therein shall be in effect and shall remain in effect until they are modified, rescinded or withdrawn. This part supersedes and replaces the interpretations previously published in the Federal Register and Code of Federal Regulations as Part 778 of this chapter. Prior opinions, rulings and interpretations and prior enforcement policies which are not inconsistent with the interpretations in this part or with the Fair Labor Standards Act as amended are continued in effect; all other opinions, rulings, interpretations, and enforcement policies on the subjects discussed in the interpretations in this part are rescinded and withdrawn. Questions on matters not fully covered by this part may be addressed to the Administrator of the Wage and Hour Division, U.S. Department of Labor, Washington, D.C. 20210, or to any Regional Office of the Division.

3. Section 778.101 is revised as follows:

§ 778.101 Maximum nonovertime hours.

As a general standard, section 7(a) of the Act provides 40 hours as the maximum number that an employee subject to its provisions may work for an employer in any workweek without receiving additional compensation at not less than the statutory rate for overtime. Hours worked in excess of the statutory maximum in any workweek are overtime hours under the statute; a workweek no longer than the prescribed maximum is a nonovertime workweek under the Act, to which the pay requirements of section 6 (minimum wage and equal pay) but not those of section 7(a) are applicable.

4. Section 778.102 is revised as follows:

§ 778.102 Application of overtime provisions generally.

Since there is no absolute limitation in the Act (apart from the child labor provisions and regulations thereunder) on the number of hours that an employee may work in any workweek, he may work as many hours a week as he and his employer see fit, so long as the required overtime compensation is paid him for hours worked in excess of the maximum workweek prescribed by section 7(a). The Act does not generally require, however, that an employee be paid overtime compensation for hours in excess of eight per day, or for work on Saturdays, Sundays, holidays or regular days of rest. If no more than the maximum number of hours prescribed in the Act are actually worked in the workweek, overtime compensation pursuant to section 7(a) need not be paid. Nothing in the Act, however, will relieve an employer of any obligation he may have assumed by contract or of any obligation imposed by other Federal or State law to limit overtime work or to pay premium rates for work in excess of a daily standard or for work on Saturdays, Sundays, holidays, or other periods outside of or in excess of the normal or regular workweek or workday. (The effect of making such payments is discussed in §§ 778.201–207 and 778.219.)

5. Section 778.107 is revised as follows:

§ 778.107 General standard for overtime pay.

The general overtime pay standard in section 7(a) requires that overtime must be compensated at a rate not less than one and one-half times the regular rate at which the employee is actually employed. The regular rate of pay at which the employee is employed may in no event be less than the statutory minimum. (The statutory minimum is the specified minimum wage applicable under section 6 of the Act, except in the case of workers specially provided for in section 14 and workers in Puerto Rico, the Virgin Islands, and American Samoa who are covered by wage orders issued pursuant to section 8 of the Act.) If the employee’s regular rate of pay is higher than the statutory minimum, his overtime compensation must be computed at a rate not less than one and one-half times such higher rate. Under certain conditions prescribed in section 7(f), (g), and (i), the Act provides limited exceptions to the application of the general standard of section 7(a) for computing overtime pay based on the regular rate. With respect to these, see §§ 778.400 through 778.421 and 778.601 and Part 548 of this chapter. The Act also provides, in section 7(b), (k) and (m) and in section 13, certain partial and total exemptions from the application of section 7(a) to certain employees and under certain conditions. Regulations and interpretations concerning these exemptions are outside the scope of this Part 778 and reference should be made to other applicable parts of this chapter.

6. Section 778.110 is revised as follows:

§ 778.110 Hourly rate employee.

(a) Earnings at hourly rate exclusively. If the employee is employed solely on the basis of a single hourly rate, the hourly rate is his “regular rate.” For his overtime work he must be paid, in addition to his straight time hourly earnings, a sum determined by multiplying one-half the hourly rate by the number of hours worked in excess of 40 in the week. Thus a $6 hourly rate will bring, for an employee who works 46 hours, a total weekly wage of $276 (46 hours at $6 plus 6 at $3). In other words, the employee is entitled to be paid an amount equal to $6 an hour for 40 hours and $8 an hour for the 6 hours of overtime, or a total of $284.

(b) Hourly rate and bonus. If the employee receives, in addition to his earnings at the hourly rate, a production bonus of $9.20, the regular hourly rate of pay is $6.20 an hour (46 hours at $6 plus 6 hours at $3). In other words, the employee is entitled to be paid an amount equal to $6 an hour for 40 hours and $8 an hour for the 6 hours of overtime, or a total of $294.

7. Section 778.111 is revised as follows:

§ 778.111 Pieceworker.

(a) Piece rates and supplements generally. When an employee is employed on a piece-rate basis, his regular hourly rate of pay is computed by adding together his total earnings for the workweek from piece rates and all other sources (such as production bonuses) and any sums paid for waiting time or other hours worked (except statutory exclusions); this sum is then divided by the number of hours worked.
in the week for which such compensation was paid, to yield the pieceworker's "regular rate" for that week. For his overtime work the pieceworker is entitled to be paid, in addition to his total weekly earnings at this regular rate for all hours worked, a sum equivalent to one-half this regular rate of pay multiplied by the number of hours worked in excess of 40 in the week. (For an alternative method of complying with the overtime requirements of the Act as far as pieceworkers are concerned, see §776.418.) Only additional half-time pay is required in such cases where the employee has already received straight-time compensation at piece rates or by supplementary payments for all hours worked. Thus, if the employee has worked 50 hours and has earned $245.50 at piece rates for 46 hours of productive work and in addition has been compensated at $5.00 an hour for 4 hours of overtime time, his total compensation, $285.50 must be divided by his total hours of work, 50, to arrive at his regular hourly rate of pay—$5.31. For the 10 hours of overtime the employee is entitled to additional compensation of $26.55 (10 hours at $2.655). For the week's work he is thus entitled to a total of $292.05 (which is equivalent to 40 hours at $7.30 plus 10 overtime hours at $5.31).

(b) Piece rates with minimum hourly guarantee. In some cases an employee is hired on a piece-rate basis coupled with a minimum hourly guarantee. Where the total piece-rate earnings for the workweek fall short of the amount that would be earned for the total hours of work at the guaranteed rate, the employee is paid the difference. In such weeks the employee is in fact paid at an hourly rate and the minimum hourly guarantee which he was paid is his regular rate in that week. In the example just given, if the employee was guaranteed $5.50 an hour for productive working time, he would be paid $253 (40 X $.50) for the 40 hours of productive work (instead of the $245.50 earned at piece rates). In a week in which no waiting time was involved, he would be owed an additional $2.75 (half time) for each of the 6 overtime hours worked, to bring his total compensation up to $299.50 (40 hours at $.50 plus 6 hours at $.75). If he is paid at a different rate for waiting time, his regular rate is the weighted average of the 2 hourly rates, as discussed in §776.118.

8. Section 776.113 is revised as follows:

§ 776.113 Salaried employees—general.

(a) Weekly salary. If the employee is employed solely on a weekly salary basis, his regular hourly rate of pay, on which time and a half must be paid, is computed by dividing the salary by the number of hours which the salary is intended to compensate. If an employee is hired at a salary of $132.70 and if it is understood that this salary is compensation for a regular workweek of 35 hours, the employee's regular rate of pay is $182.70 divided by 35 hours, or $5.22 an hour, and when he works overtime he is entitled to receive $5.22 for each of the first 10 hours and $7.63 (one and one-half times $5.22) for each hour thereafter. If an employee is hired at a salary of $220.80 for a 40-hour week his regular rate is $5.52 an hour.

(b) Salary for periods other than workweek. Where the salary covers a period longer than a workweek, such as a month, it must be reduced to its workweek equivalent. A monthly salary is subject to translation to its equivalent weekly wage by multiplying by 12 (the number of months) and dividing by 52 (the number of weeks). A semimonthly salary is translated into its equivalent weekly wage by multiplying by 24 and dividing by 52. Once the weekly wage is arrived at, the regular hourly rate of pay will be calculated as indicated above. The regular rate of an employee who is paid a regular monthly salary of $1,040, or a regular semimonthly salary of $520 for 40 hours a week, is thus found to be $5 per hour. Under regulations of the Administrator, pursuant to the authority given to him in section 7(g)(3) of the Act, the parties may provide that the regular rates shall be determined by dividing the monthly salary by the number of working days in the month and then by the number of hours of the normal or regular workday. Of course, the resultant rate at a case must not be less than the statutory minimum wage.

9. Section 776.114, paragraph (b) is revised as follows:

§ 776.114 Fixed salary for fluctuating hours.

(b) The application of the principles above stated may be illustrated by the case of an employee whose hours of work do not customarily follow a regular schedule but vary from week to week, whose overtime work is never in excess of 50 hours in a workweek, and whose salary of $250 a week is paid with the understanding that it constitutes his compensation, except for overtime premiums, for whatever hours are worked in the workweek. If during the course of 4 weeks this employee works 40, 44, 50, and 48 hours, his regular hourly rate of pay in each of these weeks is approximately $6.25, $5.68, $5, and $5.21, respectively. Since the employee has already received straight-time compensation on a salary basis for all hours worked, only additional half-time pay is due. For the first week the employee is entitled to be paid $250; for the second week $281.38 ($250 plus 4 hours at $2.54, or 40 hours at $5.08 plus 4 hours at $8.52); for the third week $275 ($250 plus 10 hours at $2.50, or 40 hours at $5 plus 10 hours at $7.50); for the fourth week approximately $270.88 ($250 plus 8 hours at $2.61 or 40 hours at $5.21 plus 8 hours at $7.02).

10. Section 776.116 is revised as follows:

§ 776.116 Payments other than cash.

Where payments are made to employees in the form of goods or facilities which are regarded as part of wages, the reasonable cost to the employer or the fair value of such goods or of furnishing such facilities must be included in the regular rate. (See Part 531 of this chapter for a discussion as to the inclusion of goods and facilities in wages and the method of determining reasonable cost.) Where, for example, an employer furnishes lodging to his employees in addition to cash wages the reasonable cost or the fair value of the lodging (per week) must be added to the cash wages before the regular rate is determined.

11. § 776.120 examples (i) and (ii) of paragraph (a) and paragraph (b) are revised as follows:

§ 776.120 Deferred commission payments not identifiable as earned in particular workweeks.

(a) Allocation of equal amounts to each week.

Explanations

(i) If there is a monthly commission payment of $416, the amount of commission allocable to a single week is $86 ($416 X .12 = $49.92 X .50 = $86). In a week in which an employee who is due overtime compensation after 40 hours works 48 hours, dividing $86 by 48 gives the increase to the regular rate of $2. Multiplying one-half of this figure by 8 overtime hours gives the additional overtime pay due of $8. The $86 may also be multiplied by 0.083 (the appropriate decimal shown on the coefficient table) to get the additional overtime pay due of $8.

(ii) An employee received $304 in commissions for a 4-week period. Dividing this by 4 gives him a weekly increase of $76. Assume that he is due overtime compensation after 40 hours and that the 4-week period worked 40, 44, and 48 hours. He would be due additional compensation of $4.36 for the first and third week ($86 +44 =+2.82 +42-$1.92 X 4 overtime hours).
hours=$4.36), no extra compensation for the second week during which no overtime hours were worked, and $8 for the fourth week, computed in the same manner as weeks one and three. The additional overtime pay due may also be computed by multiplying the amount of the weekly increase by the appropriate decimal on the coefficient table, for each week in which overtime was worked.

(b) Allocation of equal amounts to each hour worked. Sometimes, there are facts which make it inappropriate to assume equal commission earnings for each workweek. For example, the number of hours worked each week may vary significantly. In such cases, rather than following the method outlined in paragraph (a) of this section, it is reasonable to assume that the employee earned an equal amount of commission in hours actually worked during the commission computation period. The amount of the commission payment should be divided by the number of hours worked in the period in order to determine the amount of the increase in the regular rate allocable to the commission payment. One-half of this figure should be multiplied by the number of statutory overtime hours worked by the employee in the overtime workweeks of the commission computation period, to get the amount of additional overtime compensation due for this period.

Example: An employee received commissions of $192 for a commission computation period of 96 hours, including 16 overtime hours (i.e., two workweeks of 48 hours each). Dividing the $192 by 96 gives a $2 increase in the hourly rate. If the employee is entitled to overtime after 40 hours in any workweek, he is due an additional $16 for the 16 hours worked over 40.

§ 778.206 Premiums for work outside basic workday or workweek—examples.

The effect of section 7(e)(7) where "clock pattern" premiums are paid may be illustrated by reference to provisions typical of the applicable collective bargaining agreements traditionally in effect between employers and employees in the longshore and stevedoring industries. These agreements specify straight time rates applicable during the hours established in good faith under the agreement as the basic, normal, or regular workday and workweek. Under one such agreement, for example, such workday and workweek are established as the first 6 hours of work, exclusive of mealtime, each day, Monday through Friday. Between the hours of 6 a.m. and 5 p.m. Under another typical agreement, such workday and workweek is paid for at premium rates not less than one and one-half times the bona fide straight-time rates applicable to like work when performed during the basic, normal, or regular workday or workweek. The extra compensation provided by such premium rates will be excluded in computing the regular rate at which the employees so paid are employed and may be credited toward overtime compensation due under the Act. For example, if an employee is paid $5 an hour under such an agreement for handling general cargo during the basic, normal, or regular workday and $7.50 per hour for like work outside of such workday, the extra $2.50 will be excluded from the regular rate and may be credited to overtime pay due under the Act. Similarly, if the straight time rate established in good faith by the contract should be higher because of handling dangerous or obnoxious cargo, recognition of skill differentials, or similar reasons, so as to be $7.50 an hour during the hours established as the basic or normal or regular workday or workweek, and a premium rate of $11.25 an hour is paid for the same work performed during other hours of the day or week, the extra $3.75 may be excluded from the regular rate of pay and may be credited toward overtime pay due under the Act. Similar principles are applicable where agreements following this general pattern exist in other industries.

15. Section 778.215 paragraph (a)(4) is revised as follows:
§ 778.215 Conditions for exclusion of benefit-plan contributions under section 7(e)(4).

(a) General rules.

(4) The employer's contributions must be paid irrevocably to a trustee or third person pursuant to an insurance agreement, trust or other funded arrangement. The trustee must assume the usual fiduciary responsibilities imposed upon trustees by applicable law. The trust or fund must be set up in such a way that in no event will the employer be able to recapture any of the contributions paid in nor in any way divert the funds to his own use or benefit. (It should also be noted that in the case of joint employer-employee contributory plans, where the employee contributions are not paid over to a third person or to a trustee unaffiliated with the employer, violations of the Act may result if the employee contributions cut into the required minimum or overtime rates. See Part 531 of this chapter.) Although an employer's contributions made to a trustee or third person pursuant to a benefit plan must be irrevocably made, this does not prevent return to the employer of sums which he had paid in excess of the contributions actually called for by the plan, as where such excess payments result from error or from the necessity of marking payments to cover the estimated cost of contributions at a time when the exact amount of the necessary contributions under the plan is not yet ascertained. For example, a benefit plan may provide for definite insurance benefits for employees in the event of the happening of a specified contingency such as death, sickness, accident, etc., and may provide that the cost of such definite benefits, either in full or any balance in excess of specified employee contributions, will be borne by the employer. In such a case the return by the insurance company to the employer of sums paid by him in excess of the amount required to provide the benefits which, under the plan, are to be provided through contributions by the employer, will not be deemed a recapture or diversion by the employer of contributions made pursuant to the plan.

16. In § 778.219 paragraphs (a) (1) and (2) and (b) (1) and (2) are revised as follows:

§ 778.219 Pay for foregoing holidays and vacations.

(a) Sums payable whether employee works or not.

(1) An employee whose rate of pay is $5 an hour and who usually works a 6-day 48-hour week is entitled, under his employment contract, to a week's paid vacation in the amount of his usual straight-time earnings—$240. He foregoes his vacation and works 50 hours in the week in question. He is owed $250 as his total straight-time earnings for the week, and $240 in addition as his vacation pay. Under the statute he is owed an additional $25 as overtime premium (additional half-time) for the 10 hours in excess of 40. His regular rate of $5 per hour has not been increased by virtue of the payment of $240 vacation pay, but no part of the $240 may be offset against the statutory overtime compensation which is due. (Nothing in this example is intended to imply that the employee has a statutory right to $240 or any other sum as vacation pay. This is a matter of private contract between the parties who may agree that vacation pay will be measured by straight-time earnings for any agreed number of hours or days, or by total normal or expected take-home pay for the period or that no vacation pay at all will be paid. The example merely illustrates the proper method of computing overtime for an employee whose employment contract provides $240 vacation pay.)

(2) An employee who is entitled under his employment contract to 8 hours' pay at his rate of $5 an hour for the Christmas holiday, forgoes his holiday and works 9 hours on that day. During the entire week he works a total of 50 hours. He is paid under his contract, $250 as straight-time compensation for 50 hours plus 9 hours of holiday pay. He is owed, under the statute, an additional $25 as overtime premium (additional half-time) for the 10 hours in excess of 40. His regular rate of $5 per hour has not been increased by virtue of the holiday pay but no part of the $40 holiday pay may be credited toward statutory overtime compensation due.

(b) Premiums for holiday work distinguished.

(1) The typical situation is one in which an employee is entitled by contract to 8 hours' pay at his rate of $5 an hour for certain named holidays when no work is performed. If, however, he is required to work on such days, he does not receive his idle holiday pay. Instead he receives a premium rate of $7.50 (time and one-half) for each hour worked on the holiday. If he worked 9 hours on the holiday and a total of 50 hours for the week, he would be owed, under his contract, $87.50 (9 X $7.50) for the holiday work and $225 for the other 41 hours worked in the week, a total of $272.50. Under the statute (which does not require premium pay for a holiday) he is owed $275 for a workweek of 50 hours at a rate of $5 an hour. Since the holiday premium is one and one-half times the established rate for nonholiday work, it does not increase the regular rate because it qualifies as an overtime premium under section 7(e)(6), and the employer may credit it toward statutory overtime compensation due and need pay the employee only the additional sum of $2.50 to meet the statutory requirements. (For a discussion of holiday premiums see § 778.220.)

(2) If all other conditions remained the same but the contract called for the payment of $10 (double time) for each hour worked on the holiday, the employee would receive, under his contract $90 (9 X $10) for the holiday work in addition to $205 for the other 41 hours worked, a total of $295. Since this holiday premium is also an overtime premium under section 7(e)(6), it is excludable from the regular rate and the employer may credit it toward statutory overtime compensation due. Because the total thus paid exceeds the statutory requirements, no additional compensation is due under the Act. In distinguishing this situation from that in the example in paragraph (a) (2) of this section, it should be noted that the contract provisions in the two situations are different and result in the payment of different amounts. In example (2) the employee received a total of $65 attributable to the holiday: 8 hours' idle holiday pay at $5 an hour, due him whether he worked or not, and $45 pay at the nonholiday rate for 9 hours' work on the holiday. In the situation discussed in this paragraph the employee received $80 pay for working on the holiday—double time for 9 hours of work. Thus, clearly, all of the pay in this situation is paid for and directly related to the number of hours worked on the holiday.

17. Section 778.220 is revised as follows:

§ 778.220 "Show-up" or "reporting" pay.

(a) Applicable principles. Under some employment agreements, an employee may be paid a minimum of a specified number of hours' pay at the applicable straight time or overtime rate on infrequent and sporadic occasions when, after reporting to work at his scheduled starting time on a regular work day or on another day on which he has been scheduled to work, he is not provided with the expected amount of work. The amounts of time may be paid under such an agreement over and
above what the employee would receive if paid at his customary rate only for the number of hours worked are paid, to compensate the employee for the time wasted by him in reporting for work and to prevent undue loss of pay resulting from the employee's failure to provide expected work during regular hours. One of the primary purposes of such an arrangement is to discourage employers from calling their employees in to work for only a fraction of a day when they might get full-time work elsewhere. Pay arrangements of this kind are commonly referred to as "show-up" or "reporting" pay. Under the principles and subject to the conditions set forth in Subpart B of this part and §§ 778.201 through 778.207, that portion of such payment which represents compensation at the applicable rates for the straight time or overtime hours actually worked, if any, during such period may be credited as straight time or overtime compensation, as the case may be, in computing overtime compensation due under the Act. The amount by which the specified number of hours' pay exceeds such compensation for the hours actually worked is considered as a payment that is not made for hours worked. As such, it may be excluded from the computation of the employee's regular rate and cannot be credited toward overtime pay.

(b) Application illustrated. To illustrate, assume that an employee entitled to overtime pay after 40 hours a week whose workweek begins on Monday and who is paid $5 an hour reports for work on Monday according to schedule and is sent home after being given only 2 hours of work. He then works 8 hours each day on Tuesday through Thursday, inclusive, making a total of 42 hours for the week. The employment agreement covering the employees in the plant, who normally work 8 hours a day, Monday through Friday, provides that an employee reporting for scheduled work on any day will receive a minimum of 4 hours' work or pay. The employee thus receives not only the $10 earned in the 2 hours of work on Monday but an extra 2 hours' "show-up" pay, or $10 by reason of this agreement. However, since this $10 in "show-up" pay is not regarded as compensation for hours worked, the employee's regular rate remains $5 and the overtime requirements of the Act are satisfied if he receives, in addition to the $20 straight-time pay for 42 hours and the $10 "show-up" payment, the sum of $5 as extra compensation for the 2 hours of overtime work on Saturday.

18. Section 778.221 paragraph (b) is revised as follows:

§ 778.221 "Call-back" pay.

(b) Application illustrated. The application of these principles to call-back payments may be illustrated as follows: An employment agreement provides a minimum of 3 hours' pay at time and one-half for any employee called back to work outside his scheduled hours. The employees covered by the agreement, who are entitled to overtime pay after 40 hours a week, normally work 8 hours each day, Monday through Friday, inclusive, in a workweek beginning on Monday, and are paid overtime compensation at time and one-half for all hours worked in excess of 8 in any day or 40 in any workweek. Assume that an employee covered by this agreement and paid at the rate of $5 an hour works 1 hour overtime or a total of 9 hours on Monday, and works 8 hours each on Tuesday through Friday, inclusive. After he has gone home on Friday evening he is called back to perform an emergency job. His hours worked on the call total 2 hours and he receives 3 hours' pay at time and one-half, or $22.50, under the call-back provision, in addition to $200 for working his regular schedule and $7.50 for overtime worked on Monday evening. In computing overtime compensation due this employee under the Act, the 43 actual hours (not 44) are counted as working time during the week. In addition to $215 paid at the $5 rate for all these hours, he has received under the agreement a premium of $2.50 for the 1 overtime hour on Monday end of $5 for the 2 hours of overtime work on the call, plus an extra sum of $7.50 paid by reason of the provision for minimum call-back pay. For purposes of the Act, the extra premiums paid for actual hours of overtime work on Monday and on the Friday call (a total of $7.50) may be excluded as true overtime premiums in computing his regular rate for the week and may be credited toward compensation due under the Act, but the extra $7.50 received under the call-back provision is not regarded as paid for hours worked; therefore, it may be excluded from the regular rate, but it cannot be credited toward overtime compensation due under the Act. The regular rate of the employee, therefore, remains $5, and he has received an overtime premium of $2.50 an hour for 3 overtime hours of work. This satisfies the requirements of section 7 of the Act. The same would be true, of course, if in the foregoing example, the employee was called back outside his scheduled hours for the 2-hour emergency job on another night of the week or on Saturday or Sunday, instead of on Friday night.

19. Section 778.223 is revised as follows:

§ 778.223 Pay for non-productive hours distinguished.

Under the Act an employee must be compensated for all hours worked. As a general rule the term "hours worked" will include (a) all time during which an employee is required to be on duty or to be on the employer's premises or at a prescribed workplace and (b) all time during which an employee is suffered or permitted to work whether or not he is required to do so. Thus, working time is not limited to the hours spent in active productive labor, but includes time given by the employee to the employer even though part of the time may be spent in idleness. Some of the hours spent by employees, under certain circumstances, in such activities as waiting for work, remaining "on call", traveling on the employer's business or to and from workplaces, and in meal periods and rest periods are regarded as working time and some are not. The governing principles are discussed in Part 785 of this chapter (interpretative bulletin on "hours worked") and Part 790 of this chapter (statement of effect of Portal-to-Portal Act of 1947). To the extent that these hours are regarded as working time, payment made as compensation for these hours obviously cannot be characterized as "payments not for hours worked." Such compensation is treated in the same manner as compensation for any other working time and is, of course, included in the regular rate of pay. Where payment is ostensibly made as compensation for such of these hours as are not regarded as working time under the Act, the payment is nevertheless included in the regular rate of pay unless it qualifies for exclusion from the regular rate as one of a type of "payments made for occasional periods when no work is performed due to... failure of the employer to provide sufficient work, or other similar cause" as discussed in § 778.218 or is excludable on some other basis under section 7(e)(2). For example, an employment contract may provide that employees who are assigned to take calls for specific periods will receive a payment of $5 for each 8-hour period during which they are "on call" in addition to pay at their regular (or overtime) rate for hours actually spent in making calls. If the employees who are thus on call are not confined to their homes or to any particular place, but may come and go as they please,
 worked. Although the payment received by such employees for such "on call" time is, therefore, not allocable to any specific hours of work, it is clearly paid as compensation for performing a duty involved in the employee's job and is not of a type excludable under section 7(e)(2). The payment must therefore be included in the employee's regular rate in the same manner as any payment for services, such as an attendance bonus, which is not related to any specific hours of work.

20. Section 778.302 paragraph (b) is revised as follows:

§ 778.302 Computation of overtime due for overlapping workweeks.

(b) Application of rule illustrated. Suppose that, in the example given in § 778.301, the employee, who receives $5 an hour and is subject to overtime pay after 40 hours a week, worked 5 hours on Sunday, March 7, 1985. Suppose also that his last "old" workweek commenced at 7 a.m. on Monday, March 1, and he worked 40 hours March 1 through March 5 so that for the workweek ending March 7 he would be owed straight time and overtime compensation for 45 hours. The proposal is to commence the "new" workweek at 7 a.m. on March 7. If in the "new" workweek of Sunday, March 7, through Saturday, March 13, the employee worked a total of 40 hours, including the 5 hours worked on Sunday, it is obvious that the allocation of the Sunday hours to the old workweek will result in higher total compensation to the employee for the 13-day period. He should, therefore, be paid $237.50 ($5 x 4 + $7.50) for the period of March 1 through March 7, and $175 ($5 x 35) for the period of March 8 through March 13.

21. Section 778.304 paragraph (b) is revised as follows:

§ 778.304 Amounts deducted from cash wages—general.

(b) In general, where such deductions are made, the employee's "regular rate" is the same as it would have been if the occasion for the deduction had not arisen. Also, as explained in Part 531 of this chapter, the requirements of the Act place certain limitations on the making of some of the above deductions.

22. Section 778.306 paragraph (a) is revised as follows:

§ 778.306 Salary reductions in short workweeks.

(a) The reductions in pay described in subparagraph (d) of § 778.304(a) are not, properly speaking, "deductions" at all. If an employee is compensated at a fixed salary for a fixed workweek and if this salary is reduced by the amount of the average hourly earnings for each hour lost by the employee in a short workweek, the employee is, for all practical purposes, employed at an hourly rate of pay. This hourly rate is the quotient of the fixed salary divided by the fixed number of hours it is intended to compensate. If an employee is hired at a fixed salary of $200 for a 40-hour week, his hourly rate is $5. When he works only 36 hours he is therefore entitled to $180. The employer makes a "deduction" of $20 from his salary to achieve this result. The regular hourly rate is not altered.

23. Section 778.307 is revised as follows:

§ 778.307 Disciplinary deductions.

Where deductions are made in accordance with § 778.304(a)(5) for disciplinary reasons, the regular rate of an employee is computed before deductions are made, as in the case of deductions of the types in paragraphs (a), (2), and (3) of § 778.304. Thus where disciplinary deductions are made from a piece worker's earnings, the earnings at piece rates must be totaled and divided by the total hours worked to determine the regular rate before the deduction is applied. When no such deductions (or deductions of the type described in § 778.304(a)(2)) reduce the earnings to an amount below the applicable minimum wage or cut into any part of the overtime compensation due the employee. For a full discussion of the limits placed on such deductions, see Part 531 of this chapter. The principles set forth therein with relation to deductions have no application, however, to situations involving refusal or failure to pay the full amount of wages due. See Part 531 of this chapter; also § 778.306. It should be noted that although an employer may penalize an employee for lateness subject to the limitations stated above by deducting a half hour's straight time pay from his wages, for example, for each half hour, or fraction thereof of his lateness, the employer must still count as hours worked all the time actually worked by the employee in determining the amount of overtime compensation due for the workweek.

24. Section 778.308 paragraph (b) is revised as follows:

§ 778.308 The overtime rate is an hourly rate.

(b) To qualify under section 7(e)(5), the overtime rate must be greater than the regular rate, either a fixed amount per hour or a multiple of the nonovertime rate, such as one and one-third, one and one-half or two times that rate. To qualify under section 7(e)(6) or (7), the overtime rate may not be less than one and one-half times the base rate established in good faith for like work performed during nonovertime hours. Thus, it may not be less than time and one-half but it may be more. It may be a standard multiple greater than one and one-half (for example, double time); or it may be a fixed sum of money per hour which is, as an arithmetical fact, at least one and one-half times the nonovertime rate for example, if the nonovertime rate is $5 per hour, the overtime rate may not be less than $7.50 but may be set at a higher arbitrary figure such as $8 per hour.

25. Section 778.310 is revised as follows:

§ 778.310 Fixed sum for varying amounts of overtime.

A premium in the form of a lump sum which is paid for work performed during overtime hours without regard to the number of overtime hours worked does not qualify as an overtime premium, even though the amount of money may be equal to or greater than the sum owed on a per hour basis. For example, an agreement that provides for the payment of a flat sum of $75 to employees who work on Sunday does not provide a premium which will qualify as an overtime premium, even though the employee's straight time rate is $5 an hour and the employee always works less than 10 hours on Sunday. Likewise, where an agreement provides for the payment for work on Sunday of either the flat sum of $75 or time and one-half the employee's regular rate for all hours worked on Sunday, whichever is greater, the $75 guaranteed payment is not an overtime premium. The reason for this is clear. If the rule were otherwise, an employer desiring to pay an employee a fixed salary regardless of the number of hours worked in excess of the applicable maximum hours standard could merely label as overtime pay a fixed portion of such salary sufficient to take care of compensation for the maximum number of hours that would be worked. The Congressional purpose to effectuate a maximum hours standard by placing a penalty upon the performance of excessive overtime work would thus be defeated. For this reason.
where extra compensation is paid in the form of a lump sum for work performed in overtime hours, it must be included in the regular rate and may not be credited against statutory overtime compensation due.

26. Section 778.311, paragraph (b) is revised as follows:

**§ 778.311 Flat rate for special job performed in overtime hours.**

(b) Application of rule illustrated. It may be helpful to give a specific example illustrating the result of paying an employee on the basis under discussion.

(1) An employment agreement calls for the payment of $5 per hour for work during the hours established in good faith as the basic workday or workweek; it provides for the payment of $7.50 per hour for work during hours outside the basic workday or workweek. It further provides that employees doing a special task outside the basic workday or workweek shall receive 6 hours' pay at the rate of $7.50 per hour (a total payment of $45) regardless of the time actually consumed in performance. The applicable maximum hours standard is 40 hours in a workweek.

(2) Suppose an employee under such an agreement works for following schedule:

<table>
<thead>
<tr>
<th>M</th>
<th>T</th>
<th>W</th>
<th>T</th>
<th>F</th>
<th>S</th>
</tr>
</thead>
</table>
| Hours within basic workday... | 8 | 7 | 8 | 8 | 8 | 0 | 0
| Pay under contract... | $10 | $10 | $10 | $10 | $10 | 0 | 0
| Hours outside basic workday... | 2 | 2 | 1 | 0 | 0 | 0 | 0
| Pay under contract... | $15 | $15 | $7.50 | 0 | 0 | $30 | 0

*Hours spent in the performance of special work.*

(3) To determine the regular rate, the total compensation (except statutory exclusions) must be divided by the total number of hours worked. The only sums to be excluded in this situation are the extra premiums provided by a premium rate [a rate per hour] for work outside the basic workday and workweek, which qualify for exclusion under section 7(e)(7) of the Act, as discussed in §778.204. The $15 paid on Monday, the $15 paid on Wednesday, and the $15 paid on Saturday are paid pursuant to rates which qualify as premium rates under section 7(e)(7) of the Act. The total extra compensation (over the straight time pay for these hours) provided by these premium rates is $17.50. The sum of $17.50 should be subtracted from the total of $297.92 due under the contract a total of $305 for the week. The only sums which can be excluded as overtime premiums from this total before the regular rate is determined are the extra $2.50 payments for the extra hour on Thursday and Friday made because of work actually in excess of 8 hours. The payment of the other premium rates under the contract is either without regard to whether or not the hours they compensated were in excess of a bona fide daily or weekly standard or without regard to the number of overtime hours worked. Thus only the sum of $5 is excluded from the total. The remaining $300 is divided by 48 hours to determine the regular rate—$5.73 per hour. The employee is owed an additional one-half this rate under the Act for each of 8 overtime hours worked—$22.92. The extra compensation in the amount of $17.50 payable pursuant to contract premium rates which qualify as overtime premiums may be credited toward the $22.92 owed as statutory overtime premiums. No part of the $45 payment may be so credited. The employer must pay the employee an additional $5.42 as statutory overtime pay—a total of $297.92 for the week.

27. Section 778.313 is revised as follows:

**§ 778.313 Computing overtime pay under the Act for employees compensated on task basis.**

(a) An example of the operation of a plan of the second type discussed in §778.321 may serve to illustrate the effects on statutory overtime computations of payment on a task basis. Assume the following facts: The employment agreement establishes a basic hourly rate of $5 per hour, provides for the payment of $2.50 per hour for overtime work (in excess of the basic workday or workweek) and defines the basic workday as 8 hours, and the basic workweek as 40 hours, Monday through Friday. It further provides that the assembling of a machine constitutes a day's work. An employee who completes the assembling job in less than 8 hours will be paid 8 hours' pay at the established rate of $5 per hour and will receive pay at the "overtime" rate for hours worked after the completion of the task. An employee works the following hours in a particular week:

<table>
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<tr>
<th>M</th>
<th>T</th>
<th>W</th>
<th>T</th>
<th>F</th>
<th>S</th>
</tr>
</thead>
</table>
| Hours spent on task... | 6 | 7 | 7 | 9 | 8 | 6 | 0
| Day's pay under contract... | $40 | $40 | $40 | $40 | $40 | 0 | 0
| Additional hours... | 2 | 0 | 2 | 0 | 0 | 0 | 0
| Additional pay under contract... | $15 | 0 | $7.50 | $7.50 | 0 | 0 | 0

(b) In the example in paragraph (a) of this section the employee has actually worked a total of 48 hours and is owed under the contract a total of $305 for the week. The only sums which can be excluded as overtime premiums from this total before the regular rate is determined are the extra $2.50 payments for the extra hour on Thursday and Friday made because of work actually in excess of 8 hours. The payment of the

28. Section 778.317 is revised as follows:

**§ 778.317 Agreements not to pay for certain nonovertime hours.**

An agreement not to compensate employees for certain nonovertime hours stands on no better footing since it would have the same effect of diminishing the employee's total overtime compensation. An agreement, for example, to pay an employee whose maximum hours standard for the particular workweek is 40 hours, $5 an hour for the first 35 hours, nothing for the hours between 35 and 40 and $7.50 an hour for the hours in excess of 40 would not meet the overtime requirements of the Act. Unless the employee is first paid $5 for each nonovertime hour worked, the $7.50 per hour payment purportedly for overtime hours is not in fact an overtime payment.

21. Section 778.320 is revised as follows:

**§ 778.320 Hours that would not be hours worked if not paid for.**

In some cases an agreement provides for compensation for hours spent in certain types of activities which would not be regarded as working time under the Act if no compensation were provided. Preliminary and postliminary activities and time spent in eating meals between working hours fall in this category. The agreement of the parties to provide compensation for such hours may or may not convert them into hours worked, depending on whether or not it appears from all the pertinent facts that the parties have agreed to treat such time as hours worked. Except for certain activity governed by the Portal-to-Portal Act (see paragraph (b) of this section),
the agreement of the parties will be respected, if reasonable.

(a) Parties have agreed to treat time as hours worked. Where the parties have reasonably agreed to include as hours worked time devoted to activities of the type described above, payments for such hours will not have the mathematical effect of increasing or decreasing the regular rate of an employee's compensation at the same rate as other working hours. The requirements of section 7(a) of the Act will be considered to be met where the payments are made for time spent in activities from hours worked under the Portal-to-Portal Act of 1947 (see Parts 785 and 790 of this chapter), no agreement between the parties is that the salary now covers a time which, if compensable under section 7(h) of the Act, requiring the payment of not less than the applicable minimum wage for each hour worked, apply so that the employee's right to receive $5.71 per hour, is enforceable only under his contract. However, in overtime weeks the Administrator has the duty to insure the payment of at least one and one-half times the employee's regular rate of pay for hours worked in excess of 40 and this overtime compensation cannot be said to have been paid until all straight time compensation due the employee under the statute or his employment contract has been paid. Thus if the employee works 41 hours in a particular week, he is owed his salary for 35 hours—$200, 5 hours' pay at $5.71 per hour for the 5 hours between 35 and 40—$8.57, and 1 hour's pay at $8.57 for the 1 hour in excess of 40—$8.57, or a total of $237.12 for the week. 31. Section 778.323 is revised as follows:

§ 778.325 Effect on salary covering more than 40 hours' pay.

The same reasoning applies to salary covering straight time pay for a longer workweek. If an employee whose maximum hours standard is 40 hours was hired at a fixed salary of $275 for 55 hours of work, he was entitled to a statutory overtime premium for the 15 hours in excess of 40 at the rate of $2.50 per hour (half-time) in addition to his salary, and to statutory overtime pay of $7.50 per hour (time and one-half) for any hours worked in excess of 55. If the scheduled workweek is later reduced to 40 hours, with the understanding between the parties that the salary will be paid as the employee's nonovertime compensation for each workweek of 55 hours or less, his regular rate in any overtime week of 55 hours or less is determined by dividing the salary by the number of hours worked to earn it in that particular week, and additional half-time, based on that rate, is due for each hour in excess of 45. In weeks of 55 hours or more, his regular rate remains $5 per hour and he is due, in addition to his salary, extra compensation of $2.50 for each hour over 40 but not over 55 and full time and one-half, or $7.50, for each hour worked in excess of 55. If, however, the understanding of the parties is that the salary now covers a fixed workweek of 50 hours, his regular rate is $5.50 per hour in all weeks. This assumes that when an employee works less than 50 hours in a particular week, deductions are made at a rate of $5.50 per hour for the hours not worked. 33. Section 778.326 is revised as follows:

§ 778.326 Reduction of regular overtime workweek without reduction of take-home pay.

The reasoning applied in the foregoing sections does not, of course, apply to a situation in which the former earnings at both straight time and overtime are paid to the employee for the reduced workweek. Suppose an employee was hired at an hourly rate of $5 an hour and regularly worked 50 hours, earning $250 as his total straight time and overtime compensation, and the parties now
agrees to reduce the workweek to 45 hours without any reduction in take-home pay. The parties in such a situation may agree to an increase in the hourly rate from $5 per hour to $6 so that for a workweek of 45 hours (the reduced schedule) the employee’s straight time and overtime earnings will be $325. The parties cannot, however, agree that the employee is to receive exactly $20 per hour and $5 as an overtime premium (including overtime pay) for a workweek varying, for example, up to 50 hours, unless he does so pursuant to contracts specifically permitted in section 7(f) of the Act as discussed in §§778.402 through 778.414.

An employer cannot otherwise discharge his statutory obligation to pay overtime compensation to an employee who does not work the same fixed hours each week by paying a fixed amount purporting to cover both straight time and overtime compensation for an “agreed” number of hours. To permit such a practice without proper statutory safeguards would result in sanctioning the circumvention of the provisions of the Act which require that an employee who works more than 40 hours in any workweek be compensated, in accordance with express congressional intent, at a rate not less than one and one-half times his regular rate of pay for the burden of working long hours. In arrangements of this type, no additional financial pressure would fall upon the employer and no additional compensation would be due to the employee under such a plan until the workweek exceeded 50 hours.

34. Section 778.327 is revised as follows:

§778.327 Temporary or sporadic reduction in schedule.

(a) The problem of reduction in the workweek is somewhat different where a temporary reduction is involved. Reductions for the period of a dead or slow season follow the rules announced above. However, reduction on a more temporary or sporadic basis presents a different problem. It is obvious that as a matter of simple arithmetic an employer might adopt a series of different rates for the same work, varying inversely with the number of overtime hours worked in such a way that the employee would earn no more than his straight time rate no matter how long he worked. If he were paid at $8 per hour for all workweeks in which the employee worked 40 hours or less, approximately $5.93 per hour for workweeks of 41 hours, approximately $5.66 for workweeks of 42 hours, approximately $5.45 for workweeks of 50 hours, and so on, the employee would always receive (for straight time and overtime at these “rates”) $96 an hour regardless of the number of overtime hours worked. This is an obvious bookkeeping device designed to avoid the payment of overtime compensation and is not in accord with the law. See Walling v. Green Head Bit & Supply Co., 138 F.2d 453. The regular rate of pay of this employee for overtime purposes is, obviously, the rate he earns in the normal 40-hour workweek—in this case, $6 per hour.

(b) The situation is different in degree but not in principle where employees who have been at a bona fide $6 rate usually working 50 hours and taking home $330 as total straight time and overtime pay for the week are, during occasional weeks, cut back to 42 hours. If the employer raises their rate to $7.65 for such weeks so that their total compensation is $328.95 for a 42-hour week the question may properly be asked, when they return to the 50-hour week, the $2 rate and the gross pay of $110 whether the $6 rate is really their regular rate. Are they putting in 8 additional hours of work for that extra $7.65 or is their “regular” rate really now $7.65 an hour since this is what they earn in the short workweek? It seems clear that where different rates are paid from week to week for the same work and where the difference is justified by no factor other than the number of hours worked by the individual employee—the longer he works the lower the rates—the device is evasive and the rate actually paid in the shorter or nonovertime week is his regular rate for overtime purposes in all weeks.

35. Section 778.408 paragraph (c) is revised as follows:

§778.408 The specified regular rate.

(c) The rate specified in the contract must also be a “regular” rate which is operative in determining the total amount of the employee’s compensation. Suppose, for example, that the compensation of an employee is normally made up in part by regular bonuses, commissions, or the like. In the past he has been employed at an hourly rate of $5 per hour in addition to which he has received a cost-of-living bonus of $7 a week and a 2-percent commission on sales which averaged $70 per week. It is now proposed to employ him under a guaranteed pay contract which specifies a rate of $7 per hour and guarantees $320 per week, but he will continue to receive his cost-of-living bonus and commissions in addition to the guaranteed pay. Bonuses and commissions of this type are, of course, included in the “regular rate” as defined in section 7(e). It is also apparent that the $5 rate specified in the contract is not a “regular rate” under the requirements of section 7(f) since it never controls or determines the total compensation he receives. For this reason, it is not possible to enter into a guaranteed pay agreement of the type permitted under section 7(f) with an employee whose regular weekly earnings are not covered up to the payment of regular bonuses and commissions of this type. This is so because even in weeks in which the employee works sufficient hours to exceed, at his hourly rate, the sum guaranteed, his total compensation is controlled by the bonus and the amount of commissions earned as well as by the hourly rate.

36. Section 778.408 is revised as follows:

§778.409 Provision for overtime pay.

The section 7(f) contract must provide for compensation at not less than one and one-half times the specified regular rate for all hours worked in excess of the applicable maximum hours standard for the specific workweek. All excessive hours, not merely those covered by the guarantee, must be compensated at one and one-half times (or a higher multiple) of the specified regular rate. A contract which guaranteed a weekly salary of $199, specified a rate of $3.60 per hour, and provided that not less than one and one-half times such rate would be paid only for all hours up to and including 46½ hours would not qualify under this section. The contract must provide for payment at time and one-half (or more) for all hours in excess of the applicable maximum hours standard in any workweek. A contract may provide a specific overtime rate greater than one and one-half times the specified rate, for example, double time. If it provides a specific overtime rate it must provide that such rate will be paid for all hours worked in excess of the applicable maximum hours standard.

37. Section 778.411 is revised as follows:

§778.411 Sixty-hour limit on pay guaranteed by contract.

The amount of weekly pay guaranteed may not exceed compensation due at the specified regular rate for the applicable maximum hours standard and at the specified overtime rate for the additional hours, not to exceed a total of 60 hours. Thus, if the maximum hours standard is 40 hours and the specified regular rate is $5 an hour the weekly guarantee cannot be greater than $350. This does not mean that an employee
employed pursuant to a guaranteed pay contract under this section may not work more than 60 hours in any week; it means merely that pay in an amount sufficient to compensate for a greater number of hours cannot be covered by the guaranteed pay. If he works in excess of 60 hours he must be paid, for each hour worked in excess of 60, overtime compensation as provided in the contract, in addition to the guaranteed amount.

36. Section 778.413 is revised as follows:

§ 778.413 Guaranty must be based on rates specified in contract.

The guaranty of pay must be “based on the rate so specified,” in the contract. If the contract specifies a regular rate of $5 and an overtime rate of $7.50 and guarantees pay for 50 hours and the maximum hours standard is 40 hours, the amount of the guaranty must be $275, if it is to be based on the rates so specified. A guaranty of $290 in such a situation would not, obviously, be based on the rates specified in the contract.

Moreover, a contract which provides a variety of different rates for shift differentials, arduous or hazardous work, stand-by time, piece-rate incentive bonuses, commissions or the like in addition to a specified regular rate and a specified overtime rate with a guaranty of pay of, say, $290 from all sources would not qualify under this section, since the guaranty of pay in such a case is not based on the regular and overtime rates specified in the contract.

39. Section 778.414 paragraph (b) is revised as follows:

§ 778.414 “Approval” of contracts under section 7(f).

(b) As a guide to employers, it may be helpful to describe a fact situation in which the making of a guaranteed salary contract would be appropriate and to set forth the terms of a contract which would comply, in the circumstances described, with the provisions of section 7(f).

Example: An employee is employed as an insurance claims adjuster; because of the fact that he must visit claimants and witnesses at their convenience, it is impossible for him or his employer to control the hours which he must work to perform his duties. During the past 6 months his weekly hours of work have varied from a low of 30 hours to a high of 58 hours. His average workweek for the period was 48 hours. In about 80 percent of the workweeks he worked less than 52 hours. It is expected that his hours of work will continue to follow this pattern. The parties agree upon a regular rate of $8 per hour. In order to provide for the employee the security of a regular weekly income the parties further agree to employ John Doe as a claims adjuster at a guaranteed compensation which provides a weekly guaranty of pay of, say, $290 from all work performed up to and including 50 hours in such workweek. 40. Section 778.501 is revised as follows:

§ 778.501 The “split-day” plan.

(a) Another device designed to evade the overtime requirements of the Act was a plan known as the “Foncon” or “split-day” plan. Under this plan the normal or regular workday is artificially divided into two portions one of which is arbitrarily labeled the “straight time portion of the day and the other the “overtime” portion. Under such a plan, an employee who would ordinarily command an hourly rate of pay well in excess of the minimum for his work is assigned a low hourly rate (often the minimum) for the first hour (or the first 2 or 4 hours) of each day. This rate is designated at the regular rate: “time and one-half” based on such rate is paid for each additional hour worked during the workday. Thus, for example, an employee is arbitrarily assigned an hourly rate of $5 per hour under a contract which provides for the payment of so-called “overtime” for all hours in excess of 4 per day. Thus, for the normal or regular 8-hour day the employee would receive $20 for the first 4 hours and $50 for the remaining 4 hours; and a total of $30 for 8 hours. (This is exactly what he would receive at the straight time rate of $6.25 per hour.) On the sixth 8-hour day the employee likewise receives $50 and the employer claims to owe no additional overtime pay under the statute since he has already compensated the employee at “overtime” rates for 20 hours of the workweek.

(b) Such a division of the normal 8-hour workday into 4 straight time hours and 4 overtime hours is purely fictitious. The employee is not paid at the rate of $5 an hour and the alleged overtime rate of $7.50 per hour is not paid for overtime work. It is not geared either to hours “in excess of the employee’s normal working hours or regular working hours” (section 7(e)(3) or for work “outside of the hours established in good faith * * * as the basic, normal, or regular workday” (section 7(e)(7)) and it cannot therefore qualify as an overtime rate. The regular rate of pay of the employee in this situation is $6.28 per hour and he is owed additional overtime compensation, based on this rate, for all hours in excess of the applicable maximum hours standard. This rule was set forth by the Supreme Court in the case of Walling v. Helmerich & Payne, 323 U.S. 37, and its validity has been reemphasized by the definition of the term “regular rate” in section 7(e) of the Act as amended.

41. Section 778.502 paragraphs (b) and (c) are revised as follows:

§ 778.502 Artificially labeling part of the regular wages a “bonus.”

(b) For example, if an employer has agreed to pay an employee $300 a week without regard to the number of hours worked, the regular rate of pay of the employee is determined each week by dividing the $300 salary by the number of hours worked in the week. The situation is not altered if the employer continues to pay the employee, whose applicable maximum hours standard is 40 hours, the same $300 each week but arbitrarily breaks the sum down into wages for the first 40 hours at an hourly rate of $4.80 an hour, overtime compensation at $7.20 per hour and labels the balance a “bonus” (which will vary from week to week, becoming smaller as the hours increase and vanishing entirely in any week in which the employee works 55 hours or more). The situation is in no way bettered if the employer, standing by the logic of his labels, proceeds to compute and pay overtime compensation due on this “bonus” by prorating it back over the hours of the workweek. Overtime compensation has still not been properly computed for this employee at his regular rate.

(c) An illustration of how the plan works over a 3-week period may serve to illustrate this principle more clearly:

(1) In the first week the employee whose applicable maximum hours standard is 40 hours, works 40 hours and receives $300. The books show he has received $192 (40 hours X $4.80 an hour) as wages and $108 overtime compensation for the 8 hours of overtime he has been worked so no overtime compensation is due.

(2) In the second week he works 45 hours and receives $300. The books show he has received $192 (40 hours X $4.80 an hour) as wages and $108 overtime compensation for the 5 hours of overtime he has been worked so no overtime compensation is due.

(3) In the third week he works 30 hours and receives $300. The books show he has received $144 (30 hours X $4.80 an hour) as wages and $156 overtime compensation for the 6 hours of overtime he has been worked so overtime compensation is due.
as wages, and the balance as a bonus of $72. Overtime compensation is then computed by the employer by dividing $72 by 45 hours to discover the average hourly increase resulting from the bonus—$1.60 per hour—and half this rate is paid for the 5 overtime hours—$4. This is improper. The employee’s regular rate in this week is $6.67 per hour. He is owed $391.65 not $304.

3. In the third week the employee works 50 hours and is paid $300. The books show that the employee received $162 for the first 40 hours and $72.10 hours; $7.20 per hour) for the 10 hours over 49, for a total of $254 and the balance as a bonus of $36. Overtime pay due on the “bonus” is found to be $3.60. This is improper. The employee’s regular rate in this week is $6 and he is owed $330, not $303.60.

43. Section 778.503 is revised as follows:

§ 778.503 Pseudo “percentage bonuses.”

As explained in § 778.210 of this part, a true bonus based on a percentage of total wages—both straight time and overtime wages—satisfies the Act’s overtime requirements, if it is paid unconditionally. Such a bonus increases both straight time and overtime wages by the same percentage, and thereby includes proper overtime compensation as an arithmetic fact. Some bonuses, however, although expressed as a percentage of both straight time and overtime wages, are in fact a sham. Such bonuses, like the bonuses described in § 778.502 of this part, are generally separated out of a fixed weekly wage and usually decrease in amount in direct proportion to increases in the number of hours worked in a week in excess of 40. The hourly rate purportedly paid under such a scheme is artificially low, and the difference between the wages paid at the hourly rate and the fixed weekly compensation is labeled a percentage of wage “bonus.”

Example: An employer’s wage records show an hourly rate of $5.62 per hour, and an overtime rate of one and one-half times that amount, or $8.43 per hour. In addition, the employer pays an alleged percentage of wage bonus on which no additional overtime compensation is paid:

<table>
<thead>
<tr>
<th>Week</th>
<th>Hours worked</th>
<th>Rate</th>
<th>Overtime Rate</th>
<th>Bonus Rate</th>
<th>Total</th>
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<tbody>
<tr>
<td>1-2</td>
<td>40</td>
<td>$5.62</td>
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<td></td>
<td></td>
<td>$8.43</td>
<td></td>
<td>$335.50</td>
</tr>
</tbody>
</table>

§ 778.601 Special overtime provisions available for hospital and residential care establishments under section 7(j).

(a) The statutory provision. Section 7(j)(1) of the Act provides, for hospital and residential care establishment employees, under prescribed conditions, an exemption from the general requirement of section 7(a) that overtime compensation be computed on a workweek basis. It permits a 14-day period to be established for the purpose by an agreement or understanding between an employer engaged in the operation of a hospital or residential care establishment, and any of his employees employed in connection therewith. The exemption provided by section 7(j)(1) applies—

if, pursuant to an agreement or understanding arrived at between the employer and employee before performance of the work, a work period of 14 consecutive days is accepted in lieu of the workweek of 7 consecutive days for purposes of overtime computation and if, for his employment in excess of 8 hours in any workday and in excess of 40 hours in such 14-day period, the employee receives compensation at a rate not less than one and one-half times the regular rate at which he is employed.

(c) The agreement or understanding. The agreement or understanding between the employer and employee to use the 14-day period for computing overtime must be entered into before the work to which it is intended to apply is performed. It may be arrived at directly, with the employee through his representative. It need not be in writing, but if it is not, a special record concerning it must be kept as required by Part 516 of this chapter. The 14-day period may begin at any hour of any day of the week; it need not commence at the beginning of a calendar day. It consists of 14 consecutive 24-hour periods, at the end of which a new 14-day period begins. The election to use the 14-day period in lieu of the workweek must, like selection of an employee’s workweek (§ 778.105) be with the intent to use such period permanently or for a substantial period of time. Changes from such period to the workweek and back again to take advantage of less onerous overtime pay liabilities with respect to particular work schedules under one system than under the other are not permissible.

(e) Use of 14-day period in lieu of workweek. Where the 14-day period is used as authorized in section 7(j), such period is used in lieu of the workweek in computing the regular rate of pay of employees to whom it applies (i.e., those of the hospital’s or residential care establishment’s employees with whom the employer has elected to enter into the necessary agreement or understanding as explained in paragraph (c) of this section). With this exception, the computation of the regular rate and the application of statutory exclusions therefrom is governed by the general principles set forth in this Part 778.

44. Section 778.602 is amended as follows:

§ 778.602 Special overtime provisions under section 7(b).

(a) Daily and weekly overtime standards. The general overtime pay requirements of the Act provide for such pay only when the number of hours worked exceeds the standard specified for the workweek; no overtime compensation on a daily basis is required. However, section 7 of the Act, in subsection (b), provides certain partial exemptions from the general overtime provisions, each of which is conditioned upon the payment to the employee of overtime compensation at a rate not less than one and one-half times the regular rate at which he is employed.

(c) The agreement or understanding. The agreement or understanding between the employer and employee to use the 14-day period for computing overtime must be entered into before the work to which it is intended to apply is performed. It may be arrived at directly, with the employee through his representative. It need not be in writing, but if it is not, a special record concerning it must be kept as required by Part 516 of this chapter. The 14-day period may begin at any hour of any day of the week; it need not commence at the beginning of a calendar day. It consists of 14 consecutive 24-hour periods, at the end of which a new 14-day period begins. The election to use the 14-day period in lieu of the workweek must, like selection of an employee’s workweek (§ 778.105) be with the intent to use such period permanently or for a substantial period of time. Changes from such period to the workweek and back again to take advantage of less onerous overtime pay liabilities with respect to particular work schedules under one system than under the other are not permissible.
which are in excess of the daily maximum are 10, and his hours in excess of the weekly maximum are 8, overtime compensation is required for 10 hours, not 8.

(b) Standards under section 7(b). The partial exemptions provided by section 7(b) apply to an employee under the conditions specified in clause (1), (2), or (3) of the subsection "if such employee receives compensation for employment in excess of 12 hours in any workday, or for employment in excess of 56 hours in any workweek, as the case may be, at a rate not less than one and one-half times the regular rate at which he is employed." As an example, suppose an employee is employed under the other conditions specified for an exemption under section 7(b) at an hourly rate of $5.20 and works the following schedule:

<table>
<thead>
<tr>
<th>Hours</th>
<th>MTWTFSS</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Worked</td>
<td>14 9 10 15 12</td>
<td>5 0 0 66</td>
</tr>
<tr>
<td>Number of overtime hours</td>
<td>Daily, 5 (hours over 12); weekly, 12 (hours over 56)</td>
<td></td>
</tr>
</tbody>
</table>

Since the weekly overtime hours are greater, the employee is entitled to pay for 12 hours at $7.80 an hour (\(1\frac{1}{4} \times $5.20\)), a total of $93.60 for the overtime hours, and to pay at his regular rate for the remaining 56 hours ($5.20) in the amount of $291.20 or a total of $384.80 for the week. If the employee had not worked the 8 hours on Saturday, his total hours worked in the week would have been 60, of which five were daily overtime hours, and there would have been no weekly overtime hours under the section 7(b) standard. For such a schedule the employee would be entitled to 5 hours of overtime pay at time and one-half (5 \times \frac{1}{2} \times $5.20 = $9) plus the pay at his regular rate for the remaining 55 hours ($5.20 \times 55 = $286), making a total of $325 due him for the week.

§ 778.603 [Removed]

45. Section 778.603 is removed.


| Number of overtime hours | Daily, 5 (hours over 12); weekly, 12 (hours over 56) |

Order 12044 (44 FR 12661, March 23, 1979). Section 414(c)(1) of the Act provides that the prohibitions and limitations of sections 409 and 407(a) will not apply until June 30, 1984, to a loan of money or other extension of credit between a plan and a party in interest, provided, among other things, that the loan or extension of credit is made pursuant to either a binding contract which was in effect on July 1, 1974, or renewals of such a contract. Section 414(c)(2) of the Act contains similar provisions with respect to leases or joint uses of property involving a plan and a party in interest and, under section 414(c)(3), property described in section 414(c)(2) may, until June 30, 1984, be the subject of a sale, exchange, or other disposition between the plan and the party in interest provided that the plan receives no less than, or pays no more than, fair market value for the property.

The Department received a number of public comments on the proposals, some of which suggested revisions in the proposed regulations. The major comments are discussed below.

A. Regulation 414c-3(b)(2)—The “50 percent rule.”

Proposed regulation section 414c-3(b)(2) provided that property will not be regarded as the subject of a lease or joint use between a plan and a party in interest to the extent that one or more unrelated persons leases or jointly uses any portion or portions of such property representing a total value equal to or greater than the value of the portion of the property leased to or jointly used by a party in interest and the plan. Some commentators suggested that this so-called “50-percent rule” be deleted because it is not specifically provided for in the legislation and because the party in interest leasing or jointly using the less valuable portion of the property might still be the most interested prospective buyer of the property.

The Department does not find these comments persuasive. In the Department’s view, the principal purpose of the transitional rule contained in section 414(c)(2) is to prevent undue hardship that might result if a plan could not sell property to the best available buyer because the property is subject to a lease or joint use between the plan and a party in interest. In those cases where one or more unrelated parties lease or jointly use a portion of the property which is more valuable than the portion leased or
justly used by a party in interest, it does not appear to the Department that there is a reasonable basis to expect, as a general matter, that a party in interest will be the best available buyer. However, it should be noted that, in accordance with the statutory language, the regulation would permit the sale of that part of the property actually leased or jointly used by the plan or the party in interest.

One commentator suggested that Regulation 414c-3(b)(2) be modified to make clear that transitional relief under section 414(c)(3) of the Act is available for the sale of property which is leased to a party in interest who has subleased the property to a third party. The commentator indicated that the subleased might be viewed as an unrelated person leasing a portion of the property equal in value to the portion of the property leased by the party in interest. The Department does not intend that the "50 percent rule" should operate in a manner which would limit the use to which a party in interest may put property leased from a plan. In order to eliminate any confusion, the final regulation has been revised to make clear that the transitional relief under section 414(c)(3) would not be unavailable merely because property leased or jointly used by a party in interest were subleased to, or jointly used by, an unrelated party.

B. Regulation 414c-3(b)(3)—Fair Market Value

Proposed Regulation 414c-3(b)(3) stated that the determination of fair market value for purposes of applying section 414(c)(3) to the sale between a plan and a party in interest of property leased or jointly used by a plan and a party in interest must be made without regard to any diminution in value resulting from an encumbrance, arising out of a lease or joint use, which violates any provision of the Act. The Department does not believe that Congress, in granting transitional relief, intended such encumbrances to be used as a vehicle for circumventing the other provisions of the Act.

The other restriction, contained in subparagraph (3)(B)(ii), provides that the plan trustee or named fiduciary shall not take into account any diminution in value resulting from an encumbrance arising out of a lease or joint use to the extent such encumbrances would extend beyond June 30, 1984. This provision recognizes that Congress, in section 414(c)(3) of the Act, has provided a period of transitional relief for transactions which will become prohibited after the transitional period. Thus, for example, if a lease has a termination date after June 30, 1984, a plan trustee or named fiduciary must treat the lease as if it ended on June 30, 1984 when determining the effect of the lease on the property's fair market value. The plan trustee or named fiduciary may take into account the term of the lease beyond June 30, 1984 only if the lease is the subject of an administrative exemption issued pursuant to section 408(a) of the Act.

The Department believes that this approach accommodates the need for flexibility identified by the commentators with the intent of Congress in providing this transitional period.

By adopting regulation section 414c-3(b)(3), the Department neither purports nor intends to establish a general formula for the determination of fair market value in all transactions covered by the Act. Rather, the Department has adopted this provision in response to the problems described by the commentators in valuing property which is subject to a lease or joint use and which is to be sold pursuant to section 414(c)(3) of the Act.

D. Certain Other Comments

One commentator requested that the regulations provide relief for employee benefit plans which had made mortgage loans to parties in interest in situations where such loans, though made before the enactment of the Act, would not be retired before June 30, 1984. The transitional relief provided by section 414(c)(1) of the Act as well as that afforded under sections 414(c)(2) and (3) expires on June 30, 1984. On that date, all prohibited loan or lease transactions covered by the transitional relief must have been terminated and all sale transactions pursuant to section 414(c)(3) of the Act must have been consummated, unless an administrative exemption granted by the Department in accordance with section 408(a) of the Act or another statutory exemption is available. The Department does not have the authority to adopt regulations under section 414 which would extend, beyond the above date, the application of the transition rules.

Another commentator requested that sections 414c-2 and 414c-3 of the regulation be revised to include a definition of the term "property" which would provide transitional relief for the disposition by a plan of a controlling interest in the stock of a corporation whose only significant assets are property subject to a lease or joint use between a plan and a party in interest. The Department is not persuaded that the class of transactions described would, in all cases, have the same economic effect as would the disposition of the property itself. Accordingly, the Department is not prepared to state, as a general matter, that the relief provided by section 414(c)(2) would be available in those situations.

F. Retroactivity

Several comments received by the Department suggested that these regulations be effective prospectively only, rather than retroactively to January 1, 1975, as originally proposed. The commentators argued that certain requirements of these regulations are not readily apparent from a reading of the Act and the legislative history. They especially noted that the Department's definition of the term "fair market value" in regulation 414c-3(b)(3) may cast doubt upon the validity of transactions previously entered in good faith by plan fiduciaries based on their
interpretations of sections 2550.414c(1), (2), and (3) of the Act in the absence of regulations.

In granting the Department believes that these regulations, as adopted, do not alter the impact of the provisions of section 2550.414c(1), (2), and (3). However, upon consideration of the commentators' special concern regarding regulation 2550.414c-3, the Department has decided to make regulations 2550.414c-3 effective 30 days after the date of its publication in the Federal Register. Regulations 2550.414c-1 and 2550.414c-2 are effective, as proposed, as of January 1, 1975.

Statutory Authority: The regulations set forth below are adopted pursuant to the authority contained in section 505 of the Act (Pub. L. 93-406, 88 Stat. 894 (29 U.S.C. 1135)).

Final Regulation: The Department has considered all of the comments received on the proposed regulations, and has determined to adopt the modified regulations set forth below. Accordingly, Part 2550 of Chapter XXV of Title 29 of the Code of Federal Regulations is amended by adding in the appropriate places to read §§ 2550.414c-1, 2550.414c-2, and 2550.414c-3 as set forth below:

§ 2550.414c-1 Transitional rule relating to certain loans or other extensions of credit prior to June 30, 1984.

(a) Before June 30, 1984, sections 406 and 407(a) of the Employee Retirement Income Security Act of 1974 shall not apply with respect to a loan or other extension of credit between a plan and a party in interest under a binding contract in effect on July 1, 1974, or pursuant to renewals of such a contract, if such loan or other extension of credit remains at least as favorable to the plan as an arm's-length transaction with an unrelated party would be, and if the execution of the contract, the making of the loan, or the extension of credit was not, at the time of such execution, making, or extension, a prohibited transaction within the meaning of section 503(b) of the Internal Revenue Code of 1984 or the corresponding provisions of prior law.

(b) For purposes of this section,
(1) "Binding contract" means a contract which is binding under applicable state law;
(2) A loan or other extension of credit will not be considered to "remain at least as favorable to the plan as an arm's-length transaction with an unrelated party would be" unless:
   (i) Such loan or extension of credit, at the time of the execution of the contract and any renewal, is on terms at least as favorable to the plan as those which reasonably would be expected to exist in the case of an otherwise identical transaction in a normal commercial setting between the plan and the party in interest if they were unrelated parties, and
   (ii) The plan requires termination or modification of the contract at such time as, and in such manner and to such extent that, it reasonably would be expected to require such termination or modification in the case of an otherwise identical transaction in a normal commercial setting with the party in interest if they were unrelated parties; and
(3) "Renewal" of a contract means only a renewal which:
   (i) The plan reasonably would be expected to agree to in the case of an otherwise identical transaction in a normal commercial setting with the party in interest if they were unrelated parties, and
   (ii) Except to the extent required by paragraph (b)(2)(ii) of this section, does not result in any substantial change or modification of the terms of the existing contract.

§ 2550.414c-2 Transitional rule relating to certain leases or joint uses of property prior to June 30, 1984.

(a) Before June 30, 1984, sections 406 and 407(a) of the Employee Retirement Income Security Act of 1974 shall not apply with respect to a lease or joint use of property involving the plan and a party in interest pursuant to a binding contract in effect on July 1, 1974, or pursuant to renewals of such a contract, if such lease or joint use remains at least as favorable to the plan as an arm's-length transaction with an unrelated party would be and if the execution of the contract was not, at the time of such execution, a prohibited transaction within the meaning of section 503(b) of the Internal Revenue Code of 1984 or the corresponding provisions of prior law.

(b) For purposes of this section,
(1) "Binding contract" means a contract which is binding under applicable state law;
(2) A lease or joint use of property will not be considered to "remain at least as favorable to the plan as an arm's-length transaction with an unrelated party would be" unless:
   (i) The contract for such lease or joint use of property, at the time of the execution and any renewal thereof, is on terms at least as favorable to the plan as those which reasonably would be expected to exist in the case of an otherwise identical transaction in a normal commercial setting between the plan and the party in interest if they were unrelated parties, and
   (ii) The plan requires termination or modification of the contract at such time as, and in such manner and to such extent that, it reasonably would be expected to require such termination or modification in the case of an otherwise identical transaction in a normal commercial setting with the party in interest if they were unrelated parties; and
(3) "Renewal" of a contract means only a renewal which:
   (i) The plan reasonably would be expected to agree to in the case of an otherwise identical transaction in a normal commercial setting with the party in interest if they were unrelated parties, and
   (ii) Except to the extent required by paragraph (b)(2)(ii) of this section, does not result in any substantial change or modification of the terms of the existing contract.

§ 2550.414c-3 Transitional rule relating to certain sales, exchanges, or other dispositions of property prior to June 30, 1984.

(a) Before June 30, 1984, sections 406 and 407(a) of the Employee Retirement Income Security Act of 1974 shall not apply with respect to a sale, exchange, or other disposition of leased or jointly used property described in 29 CFR 2550.414c-2 between a plan and a party in interest Provided, That:

(1) In the case of a sale, exchange, or other disposition of such property by the plan to the party in interest, the plan receives an amount which is not less than the fair market value of the property at the time of such disposition and

(2) In the case of the acquisition of such property by the plan, the plan pays an amount which is not in excess of the fair market value of the property at the time of such acquisition.

(b) For purposes of this section:
(1) The term "property described in 29 CFR 2550.414c-2" means any property subject to a lease or joint use involving a plan and a party in interest under a binding contract in effect on July 1, 1974, or pursuant to renewals of such contracts;
(2) A property will not be regarded as the subject of a lease or joint use between a plan and a party in interest if one or more unrelated persons leases or jointly uses any portion or portions of such property representing a total value equal to or greater than the value of the portion of the property leased to or jointly used by one or more parties in interest. Property leased or jointly used by a party in interest which is subleased to or jointly used with an unrelated party shall not, solely because of such
sublease or use, be considered property leased to or jointly used by an unrelated party.

3) (A) Subject to the provisions of subparagraph (B) of this paragraph, "fair market value" shall be determined by the plan trustee or named fiduciary in light of the facts and circumstances of the particular case.

(B) In determining the fair market value of leased or jointly used property pursuant to subparagraph (A) of this paragraph, the plan trustee or named fiduciary shall not take into account any diminution in value resulting from

(i) Any encumbrance arising out of a lease or joint use which violates any provision of the Act, and

(ii) Any encumbrance, arising out of a lease or joint use, to the extent such encumbrance extends beyond June 30, 1980.

(4) The term "property" means any property or part thereof.

Signed at Washington, D.C., this 19th day of January, 1981.

Ian D. Lanoff,
Administrator, Pension and Welfare Benefit Programs, Labor-Management Services Administration, Department of Labor.

BILLING CODE 4510-20-M

PENSION BENEFIT GUARANTY CORPORATION

29 CFR Part 2609

Limitation on Guaranteed Benefits

AGENCY: Pension Benefit Guaranty Corporation.

ACTION: Final rule.

SUMMARY: This amendment to the Limitation on Guaranteed Benefits regulation adds an appendix which sets forth by year the maximum guaranteeable pension benefit that may be paid by the Pension Benefit Guaranty Corporation to a plan participant in a pension plan which terminated in that year. The amendment is necessary because of a change in the Social Security Act which created a special contribution and benefit base for plans that terminate each year since ERISA went into effect. It is intended that this appendix will be amended each year to show the maximum benefit for that year.

This appendix will be published in the Code of Federal Regulations and will provide the public with a record of all the maximum benefit amounts in one location. The PBGC feels this will be of benefit to the public.

This appendix does not amend or affect any existing portions of the text of this regulation, nor does it introduce any new requirements or restrictions. Its purpose is to notify the public of the maximum benefit for a pension plan that terminated each year since ERISA became effective.

Because the maximum guaranteeable benefit is determined under ERISA, and this appendix makes no change in the amount or its method of calculation, but simply lists these amounts for the public's knowledge, the PBGC finds that notice of and public comment on this amendment are impracticable and unnecessary. Moreover, the maximum benefit is effective when the Social Security contribution and benefit base is effective, i.e., January 1, 1981.

The PBGC has determined that this amendment to the Limitation on Guaranteed Benefits regulation is not significant under criteria prescribed by Executive Order 12044, "Improving Government Regulations", 42 FR 12661 (March 24, 1978), and the PBGC's Statement of Policy and Procedures implementing the Order, 43 FR 58237 (December 13, 1978). The reasons for this determination are that this amendment is not likely to engender substantial public interest or controversy, does not affect another Federal agency, and will not have a major economic impact.

In consideration of the foregoing, Part 2609 of Chapter XXVI, Code of Federal Regulations, is hereby amended by adding Appendix A to Part 2609 to read as follows:

Appendix A to Part 2609—Maximum Guaranteeable Monthly Benefit

The following table lists by year the maximum guaranteeable monthly benefit payable in the form of a life annuity commencing at age 65 as described by §2609.3(a)(2) to a participant in a plan that terminated in that year:

<table>
<thead>
<tr>
<th>Year</th>
<th>Maximum guaranteeable monthly benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1974</td>
<td>$750.00</td>
</tr>
<tr>
<td>1975</td>
<td>816.14</td>
</tr>
<tr>
<td>1976</td>
<td>869.22</td>
</tr>
<tr>
<td>1977</td>
<td>927.50</td>
</tr>
<tr>
<td>1978</td>
<td>1,005.68</td>
</tr>
<tr>
<td>1979</td>
<td>1,035.98</td>
</tr>
<tr>
<td>1980</td>
<td>1,115.90</td>
</tr>
<tr>
<td>1981</td>
<td>1,261.36</td>
</tr>
</tbody>
</table>


Issued at Washington, D.C., on this 50th day of January 1981.

Robert E. Nagle, Executive Director, Pension Benefit Guaranty Corporation.

BILLING CODE 7708-01-M