COMMENTS REGARDING PROPOSED TREASURY REGULATIONS
UNDER SECTION 411(d)(6)

The following comments are the individual views of the members of the Section of Taxation who prepared them and do not represent the position of the American Bar Association or the Section of Taxation.

These comments were prepared by individual members of the Employee Benefits Committee of the Section of Taxation. Principal responsibility was exercised by W. Waldan Lloyd, Mary M. Potter, Priscilla E. Ryan and Norma M. Sharara. Substantive contributions were also made by Nell Hennessy and Pamela C. Scott. The comments were reviewed by Taina Edlund, Thomas A. Jorgensen, Seth Tievsky and Diane Fuchs of the Employee Benefits Committee, by Richard L. Menson on behalf of the Committee on Government Submissions, and Stuart Lewis, Council Director for the Employee Benefits Committee.

Although many members of the Section of Taxation who participated in preparing these Comments have clients who would be affected by the federal tax principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

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EXECUTIVE SUMMARY

These comments are in response to Proposed Regulations under section 411(d)(6) of the Internal Revenue Code, published in the Federal Register on March 29, 2000, that would permit tax-qualified defined contribution plans to be amended to eliminate some optional distribution forms and would permit the amendment of all tax-qualified plans to eliminate certain in-kind distributions. In addition, the Proposed Regulations would allow certain voluntary transfers between defined contribution plans that are not permitted under the current regulations.

Optional Forms of Benefits. In response to Notice 98-29, which had solicited comments on these subjects, members of the Committee, like many other commentators, urged that employers be permitted to eliminate all optional forms of benefit under a defined contribution plan as long as the plan offers a single sum form of distribution. While the preamble acknowledges the merits of these comments, the Proposed Regulations nonetheless would continue to require an extended distribution form because it may have advantages in terms of investment selection that may be worth additional plan administrative costs. After fully reconsidering the issues involved in connection with the elimination of all optional forms of distribution other than a single sum, we continue to urge that the final Treasury regulations provide that a single sum distribution option is the only distribution form that need be offered under a defined contribution plan (other than a money purchase plan). Given participants’ ability to roll over distributions into an IRA and the availability of IRAs that provide the full range of distribution options available under plans, the administrative complexity and resulting costs of requiring plans
to retain extended payout options outweigh the benefit to participants of remaining in their employer’s plan. These administrative costs are increasingly borne by the participants in defined contribution plans and therefore adversely impact the participants whom the Proposed Regulations would seek to protect. The existence of multiple grandfathered distribution options, particularly those that are rarely selected, serves only to confuse participants and to increase both the administrative costs and the likelihood of inadvertent administrative mistakes. Because a rule requiring only a single sum distribution is simply a minimum requirement, employers of course would be free to select any other forms of distribution that they perceive to be important to their employees.

The Comments also respond to the following specific questions raised in the preamble, if the final regulations are to contain a requirement for an extended distribution form:

1. If the extended distribution form is required to be retained only for participants who have reached a specified age at the time of the distribution, that age should not be earlier than the mandatory distribution age, currently age 70½.

2. The extended distribution requirement, if retained, should be the same for both large and small businesses, given the added complexity of having to make the determination for plans near whatever cut-off line is drawn in defining “small business”. If a small business exception is created, “small business” should be defined as broadly as possible and should take into account the growth of small businesses through mergers and acquisitions.

3. Any extended distribution requirement should be satisfied if participants are allowed to transfer their defined contribution plan accounts to a defined benefit plan, although we believe that would do little to alleviate the burdens associated with retaining the extended distribution requirement.
4. A fixed period to determine the extended distribution payment period is preferable to requiring payments over the participant’s life expectancy or the joint life expectancies of the participant and his or her spouse, although even that calculation is complicated because of changes in the value of a participant’s account from year to year.

5. If an extended distribution option is to be retained, then such an exception should be permitted in all cases when there has been a corporate merger or acquisition, regardless of which plan the survivor corporation or acquirer of a trade or business decides would be the surviving plan.

6. If the final regulations permit elimination of extended distribution options but require that the option be retained for a transitional period, we recommend that the grandfathering of these distributions options be limited to distributions made within one or two years of the plan amendment effectuating the elimination. However, any transition period increases complexity, both in administration and in communicating with participants, and should not be required given the ability of participants to obtain desired distribution options in an IRA.

However, as the responses to these six questions demonstrate, the burdens associated with the extended distribution form requirement cannot be sufficiently alleviated even if all these exceptions were permitted.

**In-Kind Distributions.** The Comments recommend adoption of the proposal that a defined benefit plan be allowed to distribute an annuity contract in lieu of cash annuity payments from the plan, with the following modifications: (i) that, consistent with current practice, this type of modification would not require a plan amendment, (ii) that it is permissible to substitute distributions of annuity contracts for periodic annuity distributions of cash from a defined benefit plan as well as life annuities, and (iii) that these modifications would also be permitted in money purchase plans as well as defined benefit plans. With respect to defined contribution plans, we recommend that the Proposed Regulations be modified to permit the elimination of all types of in-kind distributions under defined contribution plans, not just marketable securities that are not
employer securities since, as indicated in the Proposed Regulations, an employer is free at any time to eliminate employer securities or any specified property as an investment option.

**Elective Transfers.** The proposed changes to the existing regulations regarding elective transfers are an excellent idea but we recommend that the proposal be changed in one regard in order for the regulations to have the intended effect of significantly increasing the instances in which participants would be given the opportunity to elect a transfer of their entire benefit to another plan. The change we recommend is that the proposal be modified to make it clear that such elective transfers do not carry with them the operational defects of the transferor plan. Without this change, we believe the elective transfer would seldom be used. We recommend that the final regulations clarify that the conditions relating to business acquisitions and dispositions contained in Treasury Regulation Section 1.410(b)-2(f) would not apply to elective transfers (i.e., the requirement that the relief in such section only applies if there has been no change in the employer’s plan, and the short period of time in which the relief is available under section 410(b)(6)(C)). In addition, we recommend that the only requirement that would apply to an elective transfer made in connection with a job transfer is that the participant electing the transfer would not receive allocations under the transferor plan for services performed in the new job.

Comments Regarding Proposed Treasury Regulations
Under Section 411(d)(6)

I. Introduction

On March 29, 2000, proposed regulations (the “Proposed Regulations”) under section 411(d)(6) of the Internal Revenue Code of 1986, as amended (the “Code”), were published in the Federal Register that would permit tax-qualified defined contribution plans to be amended to eliminate some optional distribution forms in which account balances could be paid. The Proposed Regulations also would permit the amendment of defined benefit plans, as well as defined contribution plans, to eliminate certain forms of noncash distributions (“in-kind distributions”). In addition, the Proposed Regulations would allow certain voluntary transfers between defined contribution plans that are not permitted under the current regulations.

Section 411(d)(6) generally provides that a plan will not be treated as satisfying the minimum vesting standards applicable to tax-qualified plans if any participant’s accrued benefit is decreased by a plan amendment. Section 411(d)(6)(B)(i) provides that a plan amendment that eliminates or reduces an early retirement benefit (or subsidy) attributable to a benefit accrued as of the date of the amendment is an amendment that impermissively reduces a participant’s accrued benefit. Moreover, section 411(d)(6)(B)(ii) provides that a plan amendment that eliminates an optional form of benefit is treated as reducing a participant’s accrued benefit to the extent that the amendment applies to a previously accrued benefit. Section 411(d)(6) gives the
Secretary of the Treasury authority to permit plan amendments that eliminate optional
distribution forms.

The responsiveness of the Treasury and the Service to the comments previously
submitted by members of the Committee and other commentators regarding Notice 98-29
is greatly appreciated. These Comments respond to the specific request in the preamble
to the Proposed Regulations for additional comments regarding potential relief from the
burdens of section 411(d)(6), and they make other recommendations as well. The
discussion below first addresses the proposed elimination of optional forms of benefit in
defined contribution plans, then the proposed elimination of certain in-kind distributions
and, finally, the proposed expanded right of a participant to direct the transfer of the
participant’s benefits from one employer plan to another.

II. **Elimination of Optional Forms of Benefit in Defined Contribution Plans**

A. **Background**

The current Treasury Regulations under section 411(d)(6) provide that a separate
“optional form of benefit” exists to the extent there is any variation in the features
relating to a distribution form. *See* Treas. Reg. § 1.411(d)-4, Q&A-1(b). Thus, a separate
optional form of benefit exists to the extent there is any variation in any of the following
features of a distribution form: (i) the payment schedule for the distribution; (ii) the
timing of the distribution (*i.e.*, commencement of payments and subsequent payments);
(iii) the medium of distribution (*e.g.*, in cash or in-kind); (iv) the portion of the benefit to
which such distribution features apply; and (v) the election rights applicable to the
distribution forms.

B. **Summary of Proposed Regulations**

In recognition of the fact that existing law has had the effect of increasing the
number of distribution choices available under an employee pension benefit plan, the
Proposed Regulations would permit plan sponsors to amend defined contribution plans to
eliminate all optional forms of distribution other than a single sum and an “extended
distribution form.” As noted in the preamble to the Proposed Regulations, the addition of
section 401(a)(31) to the Code in 1992, which requires all tax-qualified plans to offer
participants the right to direct the plan trustee to transfer a participant’s plan distribution
to another qualified plan or an individual retirement account (“IRA”) (a “direct
rollover”), has mitigated the need to protect all optional distribution forms available
under a plan. *See Unemployment Compensation Amendments of 1992, Public Law 102-318, § 522(a)(1).* Not only does the mandatory direct rollover option substantially
increase the possibility that retirement funds would be saved for retirement, it also gives
participants who elect a direct rollover to an IRA practically unlimited distribution
options available to them when they decide to retire. The IRA industry offers a wide
range of options as to the payment schedule, timing, medium, and election rights
applicable to distribution forms. As a result, individuals may not only replicate the
distribution forms available under their employer plans, but they also have many other
choices as to how and when they will receive their retirement money.
Under the Proposed Regulations, an “extended distribution form” is: (i) a single life annuity or (ii) substantially equal periodic payments made (not less frequently than annually), at the election of the participant, over either the single life expectancy of the participant or the joint life expectancy of the participant and the participant’s spouse (with or without redetermination of life expectancies). Prop. Treas. Reg. § 1.411(d)-4, Q&A-2(e)(3)(i)(A) and (B). If a defined contribution plan did not provide for either of these two distribution options, then the extended distribution form instead may be in the form of substantially equal payments made (not less frequently than annually) over a period at least as long as the longest period over which the participant was entitled to receive a distribution under any eliminated optional form of distribution. Prop. Treas. Reg. § 1.411(d)-4, Q&A-2(e)(3)(i)(C).

The Proposed Regulations permit the elimination of all optional forms of distribution provided that the single sum option and the extended distribution form are otherwise identical to the eliminated forms of distribution. Prop. Treas. Reg. § 1.411(d)-4, Q&A-2(e)(i). A form of distribution is “otherwise identical” to the eliminated forms only if the distribution form has all of the rights and features of the eliminated forms, other than the timing of payments after the distribution first begins, that are otherwise protected under section 411(d)(6) (or provides greater rights to a participant). Prop. Treas. Reg. § 1.411(d)-4, Q&A-2(e)(2). Thus, the single sum must be available to be distributed on all the dates on which the eliminated distribution forms could have commenced. Similarly, the commencement of the extended distribution form must be available at the same times as each eliminated distribution form could have commenced. If any eliminated distribution form was available in cash or in-kind, both the single sum
and the extended distribution form must be available in the same medium of distribution
(see discussion below under the heading “Elimination of Certain In-Kind Distributions”,
however, for the circumstances under which an in-kind distribution form can be
eliminated). Also, neither the single sum nor the extended distribution form may have an
eligibility condition that was not imposed on any eliminated distribution form, nor can
they exclude any election rights that applied to an eliminated distribution form.

C. Discussion

In previously submitted comments regarding Notice 98-29, members of the
Committee, like many other commentators, urged that employers be permitted to
eliminate all optional forms of benefit under a defined contribution plan as long as the
plan offers a single sum form of distribution. The preamble to the Proposed Regulations
states that although commentators made a strong case that only a single sum distribution
form should be required to be retained, the Proposed Regulations nonetheless would
continue to require an extended distribution form because it may have advantages that
may be worth additional plan administrative costs. The Preamble identifies as an
advantage the benefit that participants who are less sophisticated investors may derive
from an employer’s exercise of its fiduciary duty to select and monitor the investments
available under a defined contribution plan. We recognize that, although it may be
advantageous for plan participants to have their employers select and monitor the various
investment funds in which the participants’ retirement assets may be invested, this
advantage may be only marginal for participants in pay status. For example, the
investment goals of participants in pay status may sufficiently differ from the goals of
active employees so that the investments selected for the plan as a whole may not be the
most prudent investment for those participants. Also, many plans offer such a wide array
of investment alternatives that there is little difference between the choice among
numerous pre-selected funds and a choice among a “family” of mutual funds or virtually
all readily available mutual funds. The recent increase in the number of plans that offer a
so-called “brokerage window”, whereby participants can select among almost all publicly
available mutual funds, indicates that the trend to increase the number of investment
options available under participant-directed investment plans is growing.

After fully reconsidering the issues involved in connection with the elimination of
all optional forms of distribution other than a single sum, we urge that the final Treasury
regulations provide that a single sum distribution option is the only distribution form that
need be offered under a defined contribution plan (other than a money purchase plan).
Because such a rule would simply establish a minimum requirement, employers of course
would be free to select any other forms of distribution that they perceive to be important
to their employees. Also, we would like the Treasury Department and the Internal
Revenue Service to consider applying the new rules to the merger of money purchase
plans with other types of defined contribution plans. The complexity of administering the
annuity options in a defined contribution plan that did not have such options prior to the
merger with the money purchase plan outweighs the requirement of maintaining the
annuity options. Participants’ spouses are protected by their waiver rights.

Our recommendation is based upon the need to simplify the complex rules that
apply to the day-to-day administration of tax-qualified plans. Given participants’ ability
to roll distributions over into an IRA and the availability of IRAs providing the full range
of distribution options available under plans, the administrative complexity and resulting
costs of requiring plans to retain extended payout options outweigh any benefits realized
by participants who decide to keep their account balances in employer plans. Among the
items we considered in deciding upon our recommendation were the six questions posed
in the preamble to the Proposed Regulations. Our considerations of these questions,
which were designed to identify circumstances in which an extended distribution form
may be particularly valuable to a participant, are set forth below.

1. **Should an extended distribution form be required to be retained only for participants who have reached a specified age, such as age 55, age 62 or normal retirement age, at the time of the distribution?**

   The imposition of an age requirement would increase plan administrative burdens. Currently, plans are required to keep track only of when participants attain age 70½
(assuming plans do not include optional design features based upon age, such as an entry age requirement). A requirement to track the attainment of a younger age would require additional recordkeeping on the part of employers and software changes on the part of third-party administrators in respect of all participants, even though anecdotal data show that only a de minimis number of participants would actually elect an extended distribution form. Moreover, before such a requirement is imposed, the costs associated with redesigning distribution forms and communication materials for the benefit of so few need to be considered.
2. Should there be an exception from the extended distribution form requirement for small businesses (e.g., employers with fewer than 100 employees or fewer than 25 employees)?

Requiring all companies other than “small businesses” to retain an extended distribution form cannot be justified in light of the administrative costs associated with an extended distribution option. No data have been presented to demonstrate that an employer with more than 100 employees has more available resources to pay these costs than an employer with fewer employees. In addition, past experience has demonstrated that it is sometimes difficult to carry out the intent of small business exceptions when the number of a company’s employees increases and decreases from year to year, and that the transition in and out of small business status results in a practical inability to utilize the exception by those businesses falling near the cut-off line, wherever drawn. If a small business exception were to be adopted, we recommend that what constitutes a “small business” should be defined as broadly as possible. Although such an exception would tend to alleviate the problems encountered when an employer switches from one insurance company or mutual fund provider to another, it would do little to address the even greater problem associated with section 411(d)(6) when businesses grow through corporate mergers and acquisitions.

3. Should a plan be treated as satisfying the requirements that it retain an extended distribution form if the plan allows a participant to elect to receive a distribution by transfer of his or her vested account to a defined benefit plan for distribution in an extended distribution form?

In the event that an extended distribution form were required to be retained by a defined contribution plan, such a plan should be treated as offering an extended distribution form if the plan permitted participants to transfer their account balances to a
defined benefit plan. We note, however, that the permissibility of such a transfer may have limited utility. It would only be used, if at all, by employers that maintain both a defined contribution plan and a defined benefit plan. There would be little incentive for an employer maintaining a defined benefit plan to amend its plan to accept transfers of account balances from unrelated employers. Experience has indicated that defined benefit plans seldom permit direct rollovers (as described in section 401(a)(31)) and there is no reason to believe the proposal, if adopted, would change employers’ preferences on this design aspect of their defined benefit plans. For this reason, as well as the overall decline in the number of defined benefit plans, the adoption of such a rule would only marginally alleviate the burdens associated with section 411(d)(6).

4. **Should a plan be treated as satisfying the requirement that it retain an extended distribution form if the plan offers installment payments over a fixed period, such as 20 years?**

A fixed period to determine the extended distribution payment period is preferable to requiring payments over the participant’s life expectancy or the joint life expectancies of the participant and his or her spouse. Life expectancy calculations are administratively burdensome because they require that a plan obtain additional data from participants. When life expectancies are recalculated, the calculations can become quite burdensome.

We observe, however, that the calculation of payments over a fixed period is not as simple as it may seem at first blush. The calculation is not so simple as taking the total value of the participant’s account on the date of the first distribution and dividing by 20 (or 80 in the case of quarterly distributions; 240 in the case of monthly distributions).
Because of investment gains and losses, the value of a plan account must be determined as of each distribution date (monthly, quarterly or annually), and the amount to be distributed then must be recalculated.

Nonetheless, if fixed installments are required, a 20-year period is reasonable for participants electing distributions in connection with their normal retirement because 20 years approximates a single life expectancy of an individual retiring at age 65 or the joint life expectancies of two people aged 70½. The rationale for requiring 20-year installments decreases proportionally the younger (or older) the participant.

If an extended distribution form must be offered in addition to a single sum, plans would be required to continue administering the complex minimum distribution rules of section 401(a)(9). If the final regulations require an extended distribution form, we recommend that these periodic distributions be deemed to satisfy the minimum distribution rules of section 401(a)(9). In addition, we recommend that the distributions be calculated on the basis of the value of the participant’s account as of the last day of the preceding plan year in order to avoid difficulties in adjusting distributions to reflect gains or losses in the account during the current year.

5. Should there be an exception from the requirement that an extended distribution form be retained if a plan with an extended distribution form is merged into another plan that does not offer an extended distribution form (for example, if the plan without the extended distribution form has a larger number of
participants) in connection with an asset or stock acquisition, merger or similar transaction involving a change in employer of the employees of a trade or business?

If an extended distribution option is to be retained, then such an exception should be permitted in all cases when there has been a corporate merger or acquisition, regardless of which plan the survivor corporation or acquirer of a trade or business decides would be the surviving plan. Business combinations often occur to achieve economies of scale and other synergies and provide an excellent opportunity to simplify plan administration.

6. If extended distribution forms are permitted to be eliminated, should there be additional protections, such as requiring that the amendment not go into effect for a specified period (such as two, four or five years) or that the amendment not apply to participants who have reached a specified age (such as age 55, age 52 or normal retirement age) at the time of the amendment, or both?

Transition rules such as these cause many problems, not the least of which is adequate communication to participants. It is for this reason that some employers chose not to implement the legislative change in 1997 to section 401(a)(9) which permitted plans to provide that employees who have attained age 70½ (and who are not 5 percent owners) are not required to begin receiving minimum distributions until they retire. Despite employee communication problems, because the burden of maintaining numerous optional distribution forms outweighs the burden of calculating minimum distribution amounts, employers likely would be eager to utilize a transitional rule in order to eliminate numerous distribution options if the transition period would be of limited duration. If a transitional period is to be included in the final regulations, we believe that the period need only be a few months long because to the extent a participant finds any specific option is desirable, it can be replicated in an IRA. In any event, we
recommend all extended distributions options be permitted to be eliminated within a period of time not exceeding one or two years of the plan amendment effectuating the elimination. A transitional rule that would require plans permanently to offer extended distributions forms to participants who attained age 55, or any other age, would provide little administrative relief.

In summary, our consideration of these six questions demonstrates that the burdens associated with the extended distribution form requirement cannot be sufficiently alleviated by providing numerous limited exceptions. Furthermore, no simplification is achieved by trading the burdens of administering current law with the burdens of administering a number of exceptions to yet another new requirement. In the end, a permanent requirement for an extended distribution form also would cause additional administrative problems in the future. Employers will continue to change from one bundled-service provider to another and will continue to grow through mergers and acquisitions, with the attendant result that yet, again, the question of which extended distribution form must be retained will need to be determined. Ultimately, the impetus for the proposed change in current law, simplicity, should prevail, and the proposal that an extended distribution form, with exceptions and transitional rules, should be abandoned.
III. **Elimination of Certain In-Kind Distributions**

A. **Background**

The Proposed Regulations address the circumstances in which defined contribution plans and defined benefit plans may be amended to eliminate a participant’s right to receive a distribution in specified property (an “in-kind” distribution option). See Prop. Treas. Reg. § 1.411(d)-4, Q&A-2(b)(2)(iii)(A). As discussed in the Introduction to these Comments, the right to receive a distribution in specified property is an optional form of benefit that cannot be eliminated by plan amendment unless such a plan amendment is permitted under regulations promulgated by the Treasury Department.

B. **Defined Benefit Plans**

The Proposed Regulations would permit defined benefit plans that provide for a distribution in the form of an annuity contract to be modified to substitute the annuity contract form of distribution with a cash distribution. See Prop. Treas. Reg. § 1.411(d)-4, Q&A-2(b)(2)(iii). While we recommend that this proposal be adopted, we also recommend that it be clarified in the following three respects: (i) that this type of modification would not require a plan amendment, (ii) that it is permissible to substitute distributions of annuity contracts for periodic annuity distributions of cash from a defined benefit plan, and (iii) that these modifications would also be permitted in the case of money purchase plans. It has long been the common practice for defined benefit plans and money purchase plans to distribute an annuity contract in lieu of making annuity payouts, even if there is no express provision in the plan addressing this type of distribution. For example, when a defined benefit plan is terminated, it is typical that the
plan’s obligation to pay annuities is settled by distributing annuity contracts purchased from an insurance carrier, regardless of whether such a distribution is specifically authorized by plan terms. Similarly, it is not unusual for defined benefit plans to distribute annuity contracts to settle pension obligations to a group of retirees or terminated vested participants. Plans maintained by small businesses commonly purchase annuity contracts to satisfy the plan’s obligation to a participant with a relatively large accrued benefit. The purchase of such an annuity contract in the case of a small plan is important to the plan’s financial soundness in the event that the participant and his or her spouse outlive their life expectancies.

No participant rights would be adversely affected if this recommendation is adopted, because the participant would continue to receive an annuity payout in either case. Because of the high standard of care imposed under Title I of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), on plan fiduciaries who are charged with selection of an insurance carrier to issue annuity contracts, participants’ interests are adequately protected when the obligation to pay participants’ accrued benefits is shifted to an insurance carrier.

C. **Defined Contribution Plans**

The Proposed Regulations permit a defined contribution plan to be amended:

1. to substitute cash for distributions in the form of marketable securities other than employer securities; and
2. to limit the types of specified property that may be distributable (for which cash cannot be substituted as permitted in item 1) to those types of property in which a participant’s account is invested on the effective date of the amendment.
We recommend that the Proposed Regulations be modified to permit the elimination of all types of in-kind distributions under defined contribution plans, not just marketable securities that are not employer securities. As an example in the Proposed Regulations clearly illustrates, an employer is free at any time to eliminate employer securities or any specified property as an investment option. Prop. Treas. Reg. § 1.411(d)-4, Q&A-2(b)(2)(iii)(E), Example 1. Thus, if an employer that maintains a defined contribution plan which specifically provides that the right to receive a distribution in employer stock is available “to the extent” a participant’s account is invested in employer stock amends the plan to eliminate employer stock as an investment, the employer also effectively can eliminate employer stock distributions altogether. Employers maintaining a plan without such a phrase would be required to amend the plan in two steps in order to achieve the same result. First, the employer stock investment would need to be eliminated, and then, distributions in the form of employer stock would need to be limited to participants whose accounts are invested in employer stock at the time of distribution. See Prop. Treas. Reg. § 1.411(d)-4, Q&A-2(iii)(E), Example 2 (ii)(D). Because the plan no longer invests in employer stock, no participant would have a right to a distribution of employer stock.

It is rare that a defined contribution plan provides for a distribution in the form of nonmarketable securities or other specified property. The limited number of plans that hold investments of that kind usually provide for cash distributions. Such a distribution option is likely available under a plan either because an officer of the employer desired
such an option at one time or because the prototype or other standardized plan adopted by
the employer had such a provision. These types of situations indicate that there is no
reason to require that in-kind distribution forms be retained. If a plan sponsor thinks that
a particular in-kind distribution is valuable to participants, it will be retained, without any
regulatory provision requiring retention.

IV. Participant-Elected Account Transfers

A. Background

Under existing Treasury regulations, benefits protected under section 411(d)(6)
can be eliminated voluntarily by a participant who elects to transfer his or her vested plan
account to another plan, but only if the participant is eligible to receive an immediate
distribution of such plan account. See Treas. Reg. § 1.411(d)-4, Q&A-3(b). In the
context of a merger, acquisition or similar transaction involving an employer maintaining
a plan with a cash or deferred arrangement under section 401(k) (a “401(k) plan”), there
are only limited circumstances in which a participant’s account would be immediately
distributable. Because companies that acquire other businesses typically do not wish to
adopt the acquired business’s 401(k) plan or to accept a trust-to-trust transfer from the
acquired business’s 401(k) plan, participants are unable to consolidate their existing
401(k) plan accounts with their new accounts under the new employer plan.

B. Summary of Proposed Regulations

The preamble to the Proposed Regulations addresses this problem by liberalizing
the present rules concerning elective transfers between plans, permitting such transfers
even when the transferred benefit is not immediately distributable, if certain conditions are satisfied. One such condition is that the elective transfer be made in connection with an asset or stock acquisition, merger, or other similar transaction involving a change in employer of the employees of a trade or business (i.e., an acquisition or disposition within the meaning of Treasury Regulation Section 1.410(b)-2(f)) or in connection with the participant's transfer of employment to a different job for which service does not result in additional allocations under the transferor plan.


The Proposed Regulations also provide that the elective transfer is a transfer of assets or liabilities within the meaning of section 414(l) and therefore must satisfy all the requirements of a trust-to-trust transfer other than the retention of optional forms of benefit. Prop. Treas. Reg. § 1.411(d)-4, Q&A-3(b)(2).

C. Discussion

We believe that the Proposed Regulations regarding elective transfers would be a significant improvement over the current regulations provided that they are modified in one regard. That is, with one modification the proposed regulations would have the intended effect of significantly increasing the instances in which participants would be given the opportunity to elect a transfer of their entire benefit to another plan. The element in the proposal that we believe needs to be changed is the requirement that a participant-elected transfer be treated as a trust-to-trust transfer. Employers ordinarily will not accept trust-to-trust transfers from the plan of another employer because employers are concerned that the assets transferred will carry with them the operational defects of the transferor plan, thereby jeopardizing the tax-qualified status of the transferee plan. Employers would be even less likely to accept a trust-to-trust transfer of only one individual’s plan benefit. In addition, employers do not want to maintain
separate vesting schedules for a limited number of participants or offer qualified joint and survivor spousal annuities. Thus, the adoption of our recommendation would significantly enhance the portability of plan benefits. Unless such an elective transfer is treated like a direct rollover option, we believe it would seldom be used.

We recommend that only the provisions of section 414(l) regarding the amount to be transferred be a condition of transfer, and that other qualification requirements that the Proposed Regulations would impose on the transferee plan instead be addressed at the time of transfer, independent of the transferor plan. For example, if the transferee plan does not provide for annuity distributions, the participant would be required to obtain spousal consent in order to effectuate the transfer. Similarly, a participant’s election to transfer an account balance would be deemed to be a waiver of the participant’s right to have the vesting of the nonvested portion of his or her transferred account balance determined under the transferor plan (see § 411(a)(10)(B) regarding the right of a participant with at least three years of service to elect the former vesting schedule).

The condition that the elective transfer be made in connection with an acquisition or disposition within the meaning of Treasury Regulation Section 1.410(b)-2(f) is too restrictive because that regulatory provision only applies if there is no significant change in the employer’s plan or in the coverage of the plan other than as a result of the business transaction. We believe that a change in the employer’s plan has no connection with a participant’s decision to elect to have his or her plan benefit transferred to the new employer’s plan, and recommend that this condition be eliminated.
In addition, we believe that the section 410(b)(6)(C) transition period may be an unduly short period for plan sponsors to determine whether elective transfers will be permitted. An acquirer of a business typically would undertake a due diligence review of the transferring plan to determine whether the acquirer’s plan will accept any transfers. After a decision is made to accept transfers, communication materials would need to be prepared to inform eligible participants of their election rights and election forms would need to be drafted. In reality, twelve months might not be long enough to complete all these steps, especially in light of other pressing needs that are typically attendant with such business transactions.

As these problems with the reference to the rules under section 410(b)(6) illustrate, it is preferable to establish an independent rule to govern unrelated provisions rather than to cross-reference a regulation promulgated for a different purpose. Such an approach not only facilitates the development of a rule that safeguards important tax principles applicable to the matter at hand, but avoids inadvertent results when the cross-referenced regulation is subsequently modified. Thus, we recommend that the section 411(d)(6) regulations describe the meaning of the phrase “in connection with an acquisition or disposition” and not cross-reference any other regulatory provision. For example, the following description would suffice:

[the phrase “in connection with an acquisition or disposition” means in connection with an asset or stock acquisition or disposition, merger or other similar transaction involving a change in the employer of the employees of a trade or business.]
In the alternative, the Treasury Department should explore extending this proposal to transfers in any situation and not limit it to acquisition or disposition transactions. After all, a participant’s account would not be transferred unless he or she elects.

We also recommend that a clarification be made to the provision that the participant elective transfer provision be tested for nondiscrimination under Treasury Regulation Section 1.401(a)(4)-4. Such a right would likely be tested under the early retirement window provisions, but these provisions only apply when a participant’s employment is terminated. Elective transfers would also be beneficial in situations when there is no employment termination.

Finally, the Preamble clearly states that elective transfers may be made in connection with the transfer of a participant to a different job. An example is given that an elective transfer can be made when a participant is transferred to a subsidiary of the participant’s employer maintaining the transferor plan. There is no indication that the subsidiary must be a member of the employer’s controlled group. We note that there are often transfers of employment to joint ventures in which the participant’s employer owns a significant equity interest, but less than 80%, and assume that the elective transfer is intended to be available in such a situation. Thus, the only requirement that would apply to an elective transfer made in connection with a job transfer is that the participant electing the transfer would not receive allocations under the transferor plan for services performed in the new job.