Chapter 5
Regulation of Qualified Retirement Income Plans Generally

I. Overview of Tax Treatment of Qualified Retirement Plans

On January 2, 2018, the IRS issued Revenue Procedure 2018-4, 2018-1 I.R.B. 146 (modifying and superseding Revenue Procedure 2017-4, 2017-1 I.R.B. 146) describing determination letter and letter ruling procedures and user fees. The Revenue Procedure provides for reduced user fees for Voluntary Correction Program (“VCP”) submissions under the Employee Plans Compliance Resolution System (“EPCRS”) for corrections of plan qualification failures. The VCP user fees are now calculated based on the plan’s net assets. Plans with net assets of between $0 and $500,000 must pay a $1,500 user fee; plans with net assets of over $500,000 to $10,000,000 must pay a $3,000 user fee; plans with net assets of over $10,000,000 must pay a $3,500 user fee. The user fee for the Application for Determination for Terminating Plan (Form 5310) increased to $3,000 from $2,300. On March 29, 2018 the IRS issued Revenue Procedure 2018-19, 2018-14 I.R.B. 466, which reduced the user fee for Form 5310 from $3,000 back to $2,300. The IRS continues to re-assess the scope of the determination letter program and on April 19, 2018, the IRS published Notice 2018-24, 2018-17 I.R.B. 507 requesting comments on the scope of the determination letter program for individually designated plans by June 4, 2018 for the 2019 calendar year.

On March 22, 2018, the IRS published Announcement 2018-05, 2018-13 I.R.B. 461, announcing the delay of the second six year remedial cycle for opinion letters for pre-approved master and prototype (M&P) and volume submitter (VS) defined benefit plans to May 1, 2018 through April 30, 2020. In Revenue Procedure 2018-42, 2018-36 I.R.B. 424, the IRS extended the deadline for opinion letter applications for pre-approved defined contribution plans for the third six year remedial cycle to December 31, 2018.

On August 14, 2018, the IRS released updated VCP forms and schedules with the goal of simplifying the VCP process and correcting minor errors in the forms. On October 11, 2018, the IRS published Revenue Procedure 2018-52, 2018-42 I.R.B. 461 (superseding Revenue Procedure 2016-51, 2016-42 I.R.B. 465). The Revenue Procedure provides that starting April 1, 2019, all VCP submissions, i.e. both the user fee and the application itself, must be made entirely online through www.pay.gov with all documents included as a pdf upload. Any documents that cannot be uploaded for any reason can be faxed to the IRS, though any paper submissions via mail will not be reviewed and will be returned. However, beginning January 1, 2019 through March 31, 2018, VCP applicants may choose to submit VCP applications via www.pay.gov or may continue to submit paper applications and checks. Plan sponsors may also choose to pay Audit CAP sanctions through www.pay.gov, instead of by certified check or cashier’s check.

On December 6, 2018, the IRS issued Notice 2018-91, 2018-50 I.R.B. 985, which provides that there are no qualification requirement changes on the 2018 Required Amendments List. The Notice also generally extends the remedial amendment period for individually designed plans to the end of the second calendar year beginning after the Required Amendments List listing that change in qualification requirement is issued.

that all VCP submissions and user fees must be filed through www.pay.gov beginning April 1, 2019; however, this does not apply to user fees for submissions by pre-approved plans and requests for letter rulings, which must still be paid by check. Also, for submissions on or after July 1, 2019, the Form 5310 user fee will once again increase to $3,000. Other changes in this Revenue Procedure include adding a line for “Other Circumstances” as may be published in the Internal Revenue Bulletin as an additional category for requesting determination letters and adding Section 414(b), (c), and (m) as sections excluded from any determination made in a determination letter. The Revenue Procedure also provides that a plan must include an appropriate definition of compensation for a determination letter’s conclusion that a plan meets a nondiscrimination safe harbor to be relied upon.

II. Types of Qualified Retirement Plans

On November 1, 2018, the IRS announced in Notice 2018-83 that the 2019 Section 414(q)(1)(B) limit for a highly compensated employee (HCE) increased from $120,000 to $125,000.

A. Defined Contribution Plans

1. Profit-Sharing Plans

On November 1, 2018, the IRS announced in Notice 2018-83 that the 2019 Section 415(c)(1)(A) limit increased from $55,000 to $56,000 and the 401(a)(17) annual compensation limit increased from $275,000 to $280,000. The Section 402(g)(1) elective deferral limit increased from $18,500 to $19,000.

2. Employee Stock Ownership Plans

In Notice 2018-83, the IRS announced that the Section 409(o)(1)(C)(ii) limit increased from $1,105,000 to $1,130,000 for a 5 year distribution period and increased from $220,000 to $225,000 for lengthening the 5 year distribution period.

In Val Lanes Recreation Center Corporation v. Commissioner of Internal Revenue, Docket No. 24887-10R (June 26, 2018), T.C. Memo 2018-92 the IRS retroactively revoked an ESOP’s favorable determination letter because of a violation of the Section 415(c)(1)(A) limit, failure to have an independent appraiser annually value employer securities held, and failure to timely adopt amendments required by the determination letter. The court held that the IRS abused its discretion by revoking the favorable determination letter.

3. Money Purchase Pension Plans

B. Defined Benefit Plans

In Notice 2018-83, the IRS announced that the Section 415(b)(1)(A) annual limit increased from $220,000 to $225,000 in 2019.

C. Special Characteristics of Plans to Which More Than One Employer Contributes

President Trump issued “Executive Order on Strengthening Retirement Security in America” on August 31, 2018 directing the Department of Treasury and Department of Labor to consider expanding multiple employer plans (MEPs), reduce administrative costs and burdens associated with retirement plan required notices and disclosures, and for the Department of
Treasury to review required minimum distribution rules and related life expectancy tables. On October 22, 2018, the Department of Labor issued proposed regulation 29 CFR Part 2510 clarifying the circumstances under which an employer groups or association and professional employer organizations (PEOs) can sponsor a retirement plan, including MEPs. 83 FR 53534.

III. Calculation and Crediting of Service Under Qualified Retirement Plans

A. Hour of Service Defined
   1. Determining Service to Be Credited to Employees
   2. Equivalency Methods
      a. Working Time Method
      b. Period of Service Equivalency Method
      c. Earnings Equivalency Method
      d. Special Rules
   3. Elapsed Time Method
   4. Using Service Counting and Equivalency Methods

B. Break in Service Rules

C. Credited Time for Military Service

IV. Participation and Coverage Rules

A. Age and Service Requirements for Participation
   1. Minimum Age and Service Requirements
   2. Entry Date Rules

B. Coverage Tests for Determining Plan Qualification
   1. Highly Compensated Employees
   2. Determining the Entity to Be Tested
      a. Aggregation of Related Employers
      b. Aggregation and Disaggregation of Plans
      c. Separate Lines of Business
      d. Multiemployer and Multiple Employer Plans
   3. Minimum Coverage Tests
      a. Percentage Test
      b. Ratio Test
c. Average Benefits Percentage Test
   i. The “Reasonable Classification” Component
   ii. The “Average Benefit Percentage” Component

4. Special Application Rules
   a. Employees Who Benefit Under a Plan
   b. Exclusion and Inclusion of Certain Employees
   c. Exclusion of Part-Time Employees
   d. Rules With Respect to Former Employees

C. Minimum Participation Rules
   1. In General
   2. Prior Benefit Structures

V. Vesting and Benefit Accrual Rules
A. Minimum Vesting Rules
   1. Statutory Minimum Vesting Schedules
   2. Years of Service
   3. Forfeitures
   4. Disregard of Service for Accrual Purposes
   5. Vesting on Plan Termination

A District Court upheld a final determination by the Pension Benefit Guaranty Corporation that required that non-vested portions of benefits of all affected participants, including terminated participants who have not yet incurred a five-year break in service, became non-forfeitable on the date of the Plan termination.\(^1\)

B. Rules For Top-Heavy Plans

C. Nondiscrimination in Contributions or Benefits
   1. In General
   2. Nondiscrimination Amounts Testing
   3. Nondiscrimination Testing of Other Benefits, Rights, and Features
   4. Nondiscrimination with Respect to Plan Amendments and Terminations
   5. Corrective Amendments
   6. Permitted Disparity
   7. Definition of Compensation

D. Accrued Benefit Requirements
   1. Permissible Accrual Methods
      a) The 3 Percent Method
      b) The 133 1/3 Percent Rule
      c) The Fractional Rule
      d) Other Considerations
   2. Year of Participation
   3. Cash Balance Plans

E. Age Discrimination Rules
   1. In General
   2. Consideration of Prior Distributions
   3. Actuarial Increase in Benefits

F. Restrictions on Amendments Affecting Accrued Benefits and Optional Forms
   1. Anti-cutback Rule
      a) Statutory and Regulatory Guidance
      b) Court Decisions

The Seventh Circuit held that a change in a pension formula that assumed prospectively a specific rate of salary increase despite a history of higher increases in the past, was not an impermissible cut-back because the expectation of certain future salary increases was not an accrued benefit at the time of the change.\(^2\)

   2. Reductions of Future Benefit Accruals, Early Retirement Benefits, or Retirement-Type Subsidies

G. Other Rules Relating to Accrued Benefits
   1. First Two Years of Service
   2. Actuarial Equivalent of Accrued Benefit
   3. Allocation of Accrued Benefits Between Employer and Employee Contributions
   4. Adjusting Accrued Benefits for Prior Distributions

H. Individual Limits on Contributions and Benefits
   1. Failure to Comply
   2. General Concepts
      a) Limitation Year
      b) Applicability

\(^2\) Teufel v. Northern Trust Co., 887 F.3d 799, 801-02 (7th Cir. 2018).
VI. Funding Requirements

A. Actuarial Assumptions and Permissible Funding Methods

On October 5, 2017, the Internal Revenue Service finalized regulations updating the mortality tables plans use to calculate pension funding obligations and lump-sum payouts. The rule is effective January 1, 2018. However, the rule allows plan sponsors to delay the use of the new tables until Jan. 1, 2019 if they show the earlier date would have adverse business consequences. Plans that intend to use substitute tables for plan funding can elect to keep using their current tables for one year and then seek IRS approval to use substitute tables moving forward. Plans must submit a request to use substitute tables to the IRS by Feb. 28, 2018. No similar delay is permitted for calculating lump-sum payouts.

B. Minimum Funding Rules—Single-Employer Plans

1. Current Funding Rules

The IRS provided relief to pension plans in Texas and Florida hit by hurricanes Harvey and Irma by extending the time to make minimum funding contributions to their pension plans. If the date for making a plan contribution falls between Aug. 23, for those affected by Harvey, or Sept. 4, for those hit by Irma, and Jan. 31, 2018, the IRS is extending the deadline to Jan. 31. The deadlines are also extended to Jan. 31 for any required notices and other elections.

2. Benefit Limitations in Underfunded Plans

3. Changes to the Funding Methods

C. Waivers

D. Multiple Employer Plans

E. Penalties

1. Penalties for Insufficient Contributions

2. Penalties for Nondeductible Contributions

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3 82 FR 46388 (Oct. 5, 2017); Treasury Regulations Sections 1.430(h)(3)-1, 1.430(h)(3)-2, 1.431(c)(6)-1, and 1.433(h)(3)-1.

4 Notice 2017-49.
VII. Life Insurance in Qualified Plans
   A. Incidental Benefit Rule
   B. When Life Insurance Protection Is Considered Incidental
      1. Profit-Sharing Plans
      2. Pension Plans
      3. Taxation of Life Insurance Benefits

VIII. Deductions for Employer Contributions
   A. In General
   B. Deductibility of Employer Contributions Under Code Sections 162 and 212
   C. Deductibility of Employer Contributions to Pension Plans Under Code Section 404
   D. Deductibility of Employer Contributions to Profit-Sharing and Stock Bonus Plans
   E. Deductibility of Employer Contributions to Employee Stock Ownership Plans
   F. Combination of Plans
   G. Compensation Limit
      As discussed in the Main Volume, only an employee’s annual compensation up to the limit under Code Section 401(a)(17) may be included when determining the deductibility of employer contributions to qualified trusts. For 2018, that compensation limit is increased to $275,000.5

IX. Distributions From Plans
   A. Commencement of Distributions
      1. When Benefits Must Commence
         a. Consent Rule for Early Distributions
         b. Mandatory Distribution Events
         c. Outer Limit of Age 70½ or Retirement
         d. Death Distributions
         e. Benefits for Participants in Active Military Service
      2. Suspension of Benefits
         a. Reemployment Prior to Normal Retirement Age

b. Employment After Normal Retirement Age

c. Section 203(a)(3)(B) Service

B. Forms of Distributions

C. Survivor Benefit Requirements

1. Plans Subject to Survivor Benefit Requirements
2. Qualified Joint and Survivor Annuity
3. Qualified Optional Survivor Annuity
4. Qualified Preretirement Survivor Annuity
5. Effect of Participant’s Marital Status
6. Spousal Consent Requirements for Alternative Form of Distribution or Designation of Alternate Beneficiary
7. Notice and Election Procedures

D. Assignment and Alienation of Benefits

1. General Rule and Application

In *MetLife Life & Annuity Co. of Conn. v. Akpele*, 886 F.3d 998 (11th Cir. 2018), the parties to an interpleader action appealed the District Court’s orders granting, inter alia, the plan trustee’s motion for disbursement of funds held by the court to distribute to the surviving spouse of the decedent. In upholding the District Court, the Eleventh Circuit rejected the arguments raised by another party to the interpleader, who alleged she was entitled to the decedent’s life insurance proceeds pursuant to a settlement agreement between her and the surviving spouse. The Court reaffirmed that the terms of the employee benefit plans prevail over the purported settlement. However, the Court noted that ERISA’s anti-alienation and assignment requirements would not be implicated if suit was brought against the plan beneficiary after distribution of funds from the plan trustee.

2. Bankruptcy Code Issues

In *In re Ecle Kees*, 2018 EBC 80577 (Bankr. D. Or. Mar. 8, 2018), the Debtor had established an individual retirement account pursuant to a divorce decree, which assigned to the Debtor a share of her ex-husband’s retirement account and Code § 403(b) account. The Debtor subsequently filed a Chapter 7 petition, claiming her entire individual retirement account exempt pursuant to 11 U.S.C. § 522(d)(12). The Trustee objected, arguing the IRA was not qualified under Internal Revenue Code § 408(b) because, *inter alia*, the IRA is both forfeitable and assignable. In finding the Trustee failed to carry her burden of proof, the Court emphasized that an annuity contract’s penalty for withdrawals before its maturity date does not render any part of the IRA “forfeitable.” As to assignability, the Trustee pointed to the IRA contract’s section entitled “Assignment” in support of her argument that the IRA was assignable. The Court disagreed, noting the contract read as a whole prohibits assignments of any “Qualified” contracts, and Debtor’s contract was defined as “Qualified.” Therefore, the Court found the IRA satisfied Code § 408(b) “and, by extension,” the exemption of “[Bankruptcy Code] § 522(d)(12).”
In In re Lusk, 589 B.R. 678 (Bankr. E.D. Cal. 2018), the Debtor and his ex-spouse entered into a marital settlement agreement (“MSA”), agreeing to the spouse’s community interest in the Debtor’s defined benefit and 401(k) pension benefits. Before a QDRO was entered, the Debtor withdrew his entire 401(k) benefit and received a lump sum distribution from the defined benefit plan, and a subsequent state court proceeding ordered Debtor to liquidate and pay to his former spouse her community interest share.

Debtor filed a Chapter 13 bankruptcy petition, and his ex-spouse sought an order that the amount awarded to her by the state court as her community interest be non-dischargeable due to Debtor’s defalcation while acting in a fiduciary capacity under 11 U.S.C. § 523(a)(4). The parties did not dispute that the Debtor owed, and breached, a fiduciary duty to his former spouse. Ruling in favor of the former spouse, the Court explained that, as required by 11 U.S.C. § 523(a)(4), state law and the MSA established a trust comprised of the spouse’s community interest in the pension benefits. Debtor, moreover, committed defalcation by expending funds held by him in a fiduciary capacity, and by being unable to account for same. Finally, the Court found the Debtor’s conduct supported a finding of the requisite culpability. Accordingly, the Court found the debt non-dischargeable, but declined to impose a constructive trust as a remedy.

3. Qualified Domestic Relations Orders

In re Kiley, -- B.R. --, 2018 EBC 446837 (Bankr. Utah 2018), involved the intersection of bankruptcy law with QDROs. The Debtor had filed an action for divorce, and the day before filing for bankruptcy, she and her ex-husband stipulated that she would receive a 100% interest in his retirement benefits. A final divorce decree and award was entered a month after the filing of the bankruptcy petition, and a QDRO was entered by the Court and approved by the retirement plan three months later. The QDRO provided, in relevant part, that the plan would pay to the Debtor 100% of the participant’s interest in a lump sum as soon as administratively feasible.

In the bankruptcy proceeding, the Debtor claimed her interest awarded by the QDRO as excluded from the bankruptcy estate under 11 U.S.C. § 541(c)(2), and the Trustee objected. In granting the Trustee’s objection, the Court noted that when the Debtor filed her bankruptcy petition, she held an equitable interest in the retirement plan as marital property. However, based on the final divorce decree and the terms of the QDRO, the Court found the award (excluding a part representing child support) was property of the bankruptcy estate that was acquired within 180 days of the petition. Specifically, the Court interpreted the QDRO’s requirement that the distribution be a lump sum, to be distributed as soon as administratively feasible, and that no notice to Debtor was required before distribution, as supporting a finding that the QDRO contemplated a cash distribution to the Debtor. Although the retirement plan had not distributed any funds pursuant to the QDRO, the Court found further support for its conclusion by pointing to the divorce decree and QDRO’s absence of language suggesting that a rollover was contemplated by the Debtor.

E. Loans to Participants

F. Plan Mergers, Transfers, and Spinoffs

G. Federal Tax Treatment of Distributions

1. Periodic Payments and In-Service Withdrawals
a. Periodic Payments  

b. In-Service Withdrawals  

c. Separate Contract Rule  

2. Lump-Sum Distributions  

3. Rollovers  

a. Eligible Rollover Distributions  

b. Direct Rollovers  

c. Withholding on Eligible Rollover Distributions  

d. Nondirect Rollovers  

Section 13613 of the Tax Cuts and Jobs Act of 2017 (Pub. L. No. 115-97), extends the period during which a qualified plan loan offset amount may be contributed to an eligible retirement plan as a rollover contribution. A “qualified plan loan offset amount” is a plan loan offset amount that is treated as distributed from a qualified retirement plan, a section 403(b) plan, or a section 457(b) plan solely by reason of the termination of the plan or the failure to meet the repayment terms of the loan because of the severance from employment of the participant. Prior to the Act, an individual had 60 days to roll over a plan loan offset amount. The Act extends this time period until the due date (with extensions) for filing the participant’s federal income tax return. This provision applies to amounts that are treated as distributed in tax years beginning after December 31, 2017. 

e. Special Rules Applicable to Rollovers Between Individual Retirement Accounts and Roth IRAs  

Effective January 1, 2018, the Tax Cuts and Jobs Act of 2017 (Pub. L. No. 115-97) prohibits the recharacterization of a conversion from a traditional IRA, SEP, or SIMPLE to a Roth IRA. As discussed in the Main Volume, prior to January 1, 2018, an IRA owner who had made contributions for any taxable year to a traditional IRA and then transferred the contributions to a Roth IRA in a trustee-to-trustee transfer that same year had the ability to void the conversion and revert to a traditional IRA through a recharacterization. In a January 2018 FAQ posted on the IRS website, but not included in the I.R.B., the IRS explains that a Roth IRA conversion made in 2017 may be recharacterized as a contribution to a traditional IRA only if the recharacterization is made by October 15, 2018. A Roth IRA conversion made on or after January 1, 2018, cannot be recharacterized.6  

f. Explanation and Notice  

In Notice 2018-74 (September 19, 2018), the IRS modified the two safe harbor explanations that may be used to satisfy the requirements under § 402(f) of the Internal Revenue Code that certain information be provided to recipients of eligible rollover distributions. The updated safe harbor explanations take into consideration certain legislative changes and recent guidance, including changes related to qualified plan loan offsets (as defined in § 13613 of the

6 https://www.irs.gov/retirement-plans/ira-faqs-recharacterization-of-ira-contributions; See also, IRS Publication 590-A
Tax Cuts and Jobs Act of 2017), guidance issued on self-certification of eligibility for a waiver of the deadline for completing a rollover (described in Rev. Proc. 2016-47), and include other minor clarifying changes.

4. Employer Securities

5. Early Distributions
   a. Statutory Exceptions that Apply to Plans and IRAs

   In 2017, Congress enacted the Disaster Tax Relief and Airport and Airway Extension Act of 2017 (Pub. L. No. 115-63), to make it easier for affected retirement plan participants to access their retirement funds to recover from Hurricanes Harvey, Irma, and Maria. The Tax Cuts and Jobs Act of 2017 (Pub. L. No. 115-97), also provided limited relief to plan participants living in 2016 federally declared disaster areas who received plan distributions in 2016 and 2017. Finally, the Bipartisan Budget Act of 2018 (Pub. L. No. 115-123), provided relief to victims of the 2017 California wildfires. Under all three laws, qualified disaster distributions to retirement plan participants (including IRA owners) are exempt from the 10% additional tax on early distributions that may apply to participants under age 59 ½. In addition, participants taking qualified disaster distributions can include them in income in equal amounts over three years, beginning with the year that includes the distribution date. Participants may also repay qualified disaster distributions within three years of receiving a distribution by making one or more contributions to an eligible retirement plan. Any repayment is treated as a trustee-to-trustee transfer. A “qualified disaster distribution” is an amount up to $100,000 taken by a participant whose main home was in the federally declared disaster area and the distribution was made for:

Hurricane Harvey, after August 22, 2017, and before January 1, 2019; Hurricane Irma, after September 3, 2017, and before January 1, 2019; Hurricane Maria, after September 15, 2017, and before January 1, 2019; the 2016 federally declared disasters, in either 2016 or 2017; or the California wildfires, after October 7, 2017, and before January 1, 2019.7

   b. Statutory Exceptions that Apply to Qualified Plans and Section 403(b) Plans
   c. Statutory Exceptions for Employee Stock Ownership Plans
   d. Statutory Exceptions that Only Apply to IRAs

6. Failure to Make Minimum Required Distributions

7. Federal Tax Withholding Requirements

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7 See IRS Publication 976.