QUESTIONS AND ANSWERS WITH THE IRS

1. §125 – Cafeteria Plans

Assume that a cafeteria plan will flunk the 25% concentration of benefits tests. Are there any rules regarding the manner in which the elections by the Key Employees must be reduced?

Proposed Response. No, the contributions by the Key Employees could be reduced in any reasonable manner.

IRS Response. The IRS agrees with the proposed response.

2. §125 – Cafeteria Plans

Question. Is a health flexible spending account ("HFSA") that satisfies the requirements for the exception from HIPAA special enrollment periods pursuant to ERISA Technical Release No. 97-01 (Dec. 29, 1997) (an "Exempt HFSA") nevertheless permitted to provide a change in election (under the cafeteria plan rules, including §1.125-4T of the Temporary Treasury Regulations) when the circumstances are only those of a HIPAA special enrollment period and not those of any other change in family status or change in status?

Proposed Response. Yes. Paragraph (b) of Treas. Reg. §1.125-4T states: "A cafeteria plan may permit an employee to make a new election that corresponds with the special enrollment rights provided in section 9801(f) [of the Internal Revenue Code], whether or not the change in election is permitted under paragraph (c) of this section." (That paragraph (c) refers to the new "changes in status.") This paragraph (b) suggests that a new election that would satisfy the special enrollment rights if §9801(f) were applicable, can be described as "corresponding with" the special enrollment rights, as opposed to "made pursuant to" the special enrollment rights (a higher standard). Moreover, Technical Release 97-01 does not require that benefits under an Exempt HFSA be treated as "excepted benefits." Rather, it "clarifies the conditions under which it is appropriate to treat [such] benefits . . . as excepted benefits." If those conditions are met, the group market portability provisions (including special enrollment rights) are not mandatory. Nothing, however, prohibits an Exempt HFSA from voluntarily complying with one or more of these provisions.

IRS Response. The IRS disagrees with the proposed response. If a particular HFSA is an excepted benefit for purposes of section 9832, then the plan is not subject to the HIPAA provisions governing special enrollment rights. Thus the temporary regulations issued last year regarding cafeteria plans subject to HIPAA would not apply to an HFSA that is an excepted benefit. Many events that would trigger HIPAA special enrollment right are also change in family status events under the cafeteria plan regulations, so it is possible that an employee would be able to change a HFSA election if the plan so provides.

3. §125 – Cafeteria Plans

Question. Is an HFSA that is not an Exempt HFSA required to provide a change in election when circumstances are those of a special enrollment period?

Proposed Response. Yes. An HFSA that is not an Exempt HFSA (for example, because the employer contribution causes the maximum benefit to exceed the applicable limit) is a group health plan and is not treated as providing "excepted benefits." Accordingly, such an HFSA is required by ERISA Technical Release 97-01 to comply with the rules for special enrollment periods. Paragraph (b) of Temp. Treas. Reg. §1.125-4T states that "[a] cafeteria plan may permit an employee" to revoke an old election and make a new election that corresponds with special enrollment rights. Arguably, the latter language might imply that a cafeteria plan need not permit such a change. Technical Release 97-01 specifically addresses this situation (and was issued after the temporary regulation), and provides a limited exception for Exempt HFSAs. Accordingly, an HFSA that is not an Exempt HFSA should be governed by the general rules under §9801(f) of the Internal Revenue Code and should comply with the rules for special enrollment periods.

IRS Response. The IRS agrees with the proposed response. The IRS is not aware of any situations where a HFSA would not be an Exempt HFSA. Nevertheless, if there is such a thing, §125 doesn't require a plan to allow a change in such circumstance, but does allow a plan to offer such an election. §9801 would require compliance with the special enrollment requirements, regardless of whether the cafeteria plan allows a pre-tax election or not.

4. §125 – Cafeteria Plans

Question. Is an Exempt HFSA required under tax law or ERISA to comply with a change in coverage occasioned by a qualified medical child support order ("QMCSO")?

Proposed Response. Yes, pursuant to §609 of ERISA, but only in the case of a change mandated by the QMCSO with respect to the Exempt HFSA, and not in other cases. An Exempt HFSA is exempted by ERISA Technical Release 97-01 only from requirements under §9801 of the Internal Revenue Code, §701 of ERISA and §2701 of the Public Health Service Act. No such exemption from §609 of ERISA has been granted or implied by the Technical Release. Nevertheless, if the change in coverage under the Exempt HFSA is merely implied and not mandated by the QMCSO, the change is not required by §609 of ERISA (but may be permitted under paragraph (d) of Temp. Treas. Reg. §1.125-4T). For example, if Employee W has elected HFSA coverage that includes her child C, a QMCSO requires W's ex-spouse H to provide coverage for C under H's employer's group health plans, and the QMCSO has expressly mandated a change only under H's plan and not under W's plan, then W's plan need not allow W to cancel coverage for C consistent with the QMCSO.

IRS Response. The IRS agrees with the proposed response. If an HFSA receives a QMCSO, the plan must abide by the terms of the order, assuming the HFSA is subject to ERISA. The plan could do so either without charge, by the terms of the HFSA being amended to allow for such a change in election pursuant to the temporary §125 regulations, or by after-tax contributions.

5. §162(m) Compensation Committee - Outside Director -Status.

Question. If a member of the compensation committee that sets the performance goals with respect to the payment of compensation intended to constitute "qualified performance-based compensation" no longer qualifies as an "outside director" at the time the compensation committee certifies that the performance goals have been satisfied, will the performance goals be treated as otherwise properly set and certified, as required by §162(m) and the treasury regulations thereunder, even though a member of the compensation committee that set the performance goals fails to qualify as an "outside director" when the satisfaction of the goals are later certified?

Proposed Response. The regulations simply require that the performance goals be "established in writing by the compensation committee" and that "the compensation committee must certify in writing prior to payment of the compensation that the performance goals and any other material terms were in fact satisfied." See Reg. §.1.162-27 (e)(2)(i); (e)(5); see also §162(m)(4)(C). Accordingly, it seems that as long as the members of the compensation committee acting at the time the performance goals are established and certified qualify as "outside directors" at such time (and that there are at least two such outside directors) the mere fact that one or.more of the directors who established the goals no longer qualifies as an outside director at the time the satisfaction of the goals is certified should not cause the compensation payments to otherwise fail to constitute "qualified performance-based compensation."

IRS Response. The IRS agrees with the proposed response.

6. §401(a) – IRS Compliance Programs

Question. Are plan sponsors eligible for APRSC with respect to "insignificant" operational violations even if they do not have a current determination letter for the plan?

Proposed Response. Section 4 of the Internal Revenue Service Field Directive on Employee Plans Division (APRSC) provides that "in the case of a plan qualified under Section 401(a) of the Code, this SELF-CORRECTION procedure is available only to a sponsor of an individually designed plan (including a volume submitter plan) with a current determination letter, an adopter of a master or prototype plan with a current opinion letter, or an adopter of a regional prototype plan with a current notification letter." Section 5 of the Field Directive regarding the correction of insignificant operational violations does not contain an express reference to the favorable determination letter requirement referenced in Section 4 of the Field Directive. Therefore, it appears that insignificant operational violations may be corrected regardless of whether the plan sponsor has a current favorable determination letter.

IRS Response. The IRS agrees with the proposed response. A plan needs a current determination letter to use the VCR program and to use the portion of the APRSC program for operational defects corrected within 2 years after occurrence. A determination letter is not required to use any other IRS compliance program.

7. §401(a) – Pension Distribution Restrictions

Question. May a defined benefit plan make an in-service distribution upon the participant's attainment of early retirement age under the plan?

Proposed Response. Yes. There is support for in-service distributions particularly where the participant ceases to accrue additional benefits. In PLR 8311071 and PLR 8003135, the IRS concluded that an in-service distribution was permissible where the only difference in the amount payable at early retirement age and at normal retirement age would be the actuarial reduction for early commencement.

IRS Response. The IRS disagrees with the proposed response. In-service distributions are normal retirement age are permitted, but not at early retirement age. The date of distribution was an ancillary issue in the cited letter rulings.

8. §401(a) – High-25 restrictions

Question. A top-paid HCE in a defined benefit plan is entitled to a pension plus and additional benefit from the plan's defined contribution rollover account. Does the distribution restriction of section 401(a)(4)-5(b) apply to just the defined benefit portion of the HCEs benefit, or to the entire benefit available from the plan, including the rollover account?

Proposed Response. At a prior public conference, IRS officials indicated the limit applies to both. But 1.401(a)(4)-5(b)(1) specifically states that "the restrictions in this paragraph (b) apply to a plan within the meaning of 1.410(b)-7(b) (i.e., a section 414(l) plan)." The referenced section in the 410(b) regulation elaborates with the proviso that "the defined contribution portion of a plan described in section 414(k) is a separate plan from the defined benefit portion of that same plan." The regulations would herefore seem to support the view that the distribution restrictions for defined benefit plans do not encompass rollover accounts maintained under the plan.

IRS Response. The IRS disagrees with the proposed response. Unless one of the exceptions in the regulations applies, the plan is precluded from making distributions to restricted employees. The distribution restrictions apply to the plan as a whole, so distribution of rollover accounts maintained in the plan are precluded as well. A distribution of rollover amounts is permitted using one of the security agreements for distributions affected by the termination restrictions.

9. §401(a) – Definition of retirement

Question. A number of qualified plan rules hinge on a participant's retirement status. Examples include the ability to receive a benefit distribution prior to separation from employment and the requirement to commence distributions at the later of age 70 1/2 or retirement. How are these requirements addressed for participants who view themselves as "semi-retired" or "retired, supplementing pension with part-time work for the same employer"? Would application of such rules hinge on discretionary elections made by the employee (as opposed to the employer)?

Proposed Response. None.

IRS Response. The §401(a)(9) guidance did not address what constituted retirement. Once the status of worker changes from common law employee of the employer sponsoring the plan, the employee has retired. Other situations will be addressed on a case by case basis. Not having enough hours of service to trigger the suspension of benefit service rules is not sufficient to be considered retired. If the employee has had a bona fide quit, then the subsequent re-employment with the same employer does not require that benefits be suspended to the individual.

10. §401(b) – Remedial Amendment Period

Question. If plan amendments that are made pursuant to the Taxpayer Relief Act of 1997 ("TRA 97") are adopted on or before the last day of the first plan year beginning on or after January 1, 1999 (i.e., on or before the last day of the remedial amendment period as set forth in Revenue Procedure 98-14), and such amendments are made retroactively effective as of the beginning of remedial amendment period, will the plan amendments be treated as if they meet the requirements of §1541 of TRA 97?

TRA 97 §1541 provides certain relief with respect to TRA 97 plan amendments that are made by the *first day of the first plan year* beginning on or after January 1, 1999. According to TRA 97 §1541, amendments made by such date that are made retroactively to the effective date of the change in law will not cause a plan to be treated as if it was not operated in accordance with its own terms and will not cause the plan amendment to fail to meet the requirements of §411(d)(6) or ERISA §204(g). On the other hand, Revenue Procedure 98-14 explicitly states that the remedial amendment period with respect to TRA 97 amendment will end on the *last day of the first plan year* beginning on or after January 1, 1999. Thus, the issue arises as to

whether retroactive plan amendments must still be made by the first day of the first plan year beginning on or after January 1, 1999 in order to avoid a violation of the plan's terms or a violation of §411(d)(6) or ERISA §204(g), even though the remedial amendment period for such amendments does not end until the last day of the first plan year beginning on or after January 1, 1999. This result also would require TRA 97 amendments to made prior to the date that amendments are required to be made under the Small Business Job Protection Act of 1996 ("SBJPA"), which is the last day of the first plan year beginning on or after January 1, 1999.

Proposed Response. For purposes of TRA 97 §1541, TRA 97 plan amendments that are made during the remedial amendment period under Revenue Procedure 98-14 (i.e., on or before the last day of the plan year beginning on after January 1, 1999) shall be treated as if they were made in accordance with TRA §1541. Revenue Procedure 98-14 has the effect of extending the date by which TRA 97 amendments must be made under TRA 97 §1541 from the first day of the plan year beginning on or after January 1, 1999 to the last day of the plan year beginning on or after January 1, 1999. TRA 97 plan amendments that are adopted by the end of Revenue Procedure 98-14's remedial amendment period will not cause a plan to be treated as if it was not operated in accordance with its own terms during the remedial amendment period, and such plan amendments shall not fail to meet the requirements of §411(d)(6) or ERISA §204(g). Thus, the deadline for adopting TRA 97 amendments and SBJPA amendments is the same.

IRS Response. The IRS agrees with the proposed response. The 1998 guidance plan has an item on this issue and the IRS contemplates issuing guidance shortly on this issue.

11. §401(k) – Contingent Benefit Rule

Question. Assume that a nonqualified deferred compensation plan provides that eligibility to participate in that plan is contingent upon the individual not making any deferrals in the employer's §401(k) plan. Assume, however, that this condition was never actually imposed in practice. Would the §401(k) plan be disqualified anyway?

Proposed Response. No. If the benefits were not actually contingent upon not making any deferrals under the qualified plan, this would not violate the contingent benefit rule.

IRS Response. The IRS disagrees with the proposed response. Even though the terms and operation of the §401(k) plan comply with the requirements, the provision in the nonqualified plan document results in the violation of the contingent benefit rule. The nonqualified plan document can disqualify the §401(k) plan because of the contingent benefit rule.

12. §401(k) – Hardship Distributions

Question. In order to receive a hardship distribution, a participant must first receive any distributions that are available to him under any plans maintained by the employer. Is this limited to tax-qualified retirement plans or does it also include nonqualified plans?

Proposed Response. The loan requirement only applies to tax-qualified retirement plans.

IRS Response. The IRS disagrees with the proposed response. The provision in the regulations applies all plans, qualified and nonqualified, maintained by the employer.

13. §401(k) – Nondiscrimination testing

Question. An eligible employee terminates employment on the last day of the plan year. Wages for the last pay period are paid to the former employee in the following month. All plan accounting — records of accounts, testing of section 415 annual addition limits and nondiscrimination tests under sections 401(k) and (m) — is done on a cash, not accrual, basis.

Should such an individual be included in the nondiscrimination tests for the year following the year of termination? Is the response unchanged by whether or not the former employee actually made elective deferrals?

Proposed Response. All "eligible employees" are included in the nondiscrimination tests under code section 401(k) and (m). Regulations at section 1.401(k)-1(g)(4) define an "eligible employee" as an "employee" (emphasis added) who is directly or indirectly eligible to make a cash or deferred election under the plan for all or a portion of the plan year. Reg. 1.401(k)-1(g)(5) defines the term "employee" by reference to the regulations under section 410(b). Under those regulations, the definition of "employee" read in conjunction with the definition of "former employee" suggest that an individual

is not an employee beginning on the day after the day on which the individual ceases performing services as an employee for the employer.

Thus, an individual who does not perform services in a plan year is not included in the nondiscrimination tests under section 401(k) or (m) even if there exists compensation and deferrals during that year.

Note that the definition of "employee" in the coverage regulation specifically provides for an exception to this characterization in the case of allocations or accruals tested under section 401(a)(4) on account of ongoing service or compensation credits (such as imputed service).

IRS Response. The IRS agrees with the first paragraph of the proposed response. Only pay in the employee's final payroll period that extends into the next plan year can support §401(k) deferrals.

14. §401(m) – Matching Contributions

Question. Can a §401(k) plan for union employees cross-reference a collective bargaining agreement to determine the amount of the matching contributions?

Proposed Response. Yes. Because the rate of matching contributions can be discretionary, a plan sponsor should be able to determine the rate of matching contribution by cross-reference to a collective bargaining agreement.

IRS Response. The IRS agrees with the proposed response. The discretionary match can be set any way the plan sponsor wants, including by collective bargaining agreement.

15. §402(b) – Secular Trust

Question. Assume that a participant's account in a Secular Trust is invested in a whole life insurance policy. Will the participant be taxed each year in the increase in the cash surrender value of the policy under §402(b)?

Proposed Response. Yes, §402(b) applies regardless of how the assets of the Secular Trust are invested.

IRS Response. The IRS agrees with the proposed response, assuming the employee is a highly compensated employee, vested in the benefit, and the plan fails a §410(b) coverage test, since §402(g) only taxes highly compensated employee's vested interest in such plans.

16. §402(f) – Tax Notice to Participants

Question. Can an employer avoid the necessity of having to distribute the notice describing the tax treatment of distributions (including the direct rollover rules) by attaching it to the SPD and placing a statement in the SPD that participants must read the notice at least 30 days prior to receiving a distribution?

Proposed Response. No.

IRS Response. The IRS agrees with the proposed response.

17. §403(b) – Tax-sheltered Annuities

Question. Can the sponsor of a §403(b) program that is subject to ERISA (and thus the minimum age and service participation rules) use the 20 hour §403(b)(12) exception?

Proposed Response. No.

IRS Response. The IRS disagrees with the proposed response. Such a plan can use the 20 hour employee exclusion when determining if the plan passes the nondiscrimination standards of §403(b)(12), but not for determining the employees that participate in the plan.

18. §403(b) – Tax-sheltered Annuities

Question. A non-profit corporate employer terminates its participation in and contributions (matching and salary deferral) to a

§403(b) plan and establishes a §401(k) plan. Upon the termination of the §403(b) plan participation, can the individual plan participants roll their account balances over to an IRA? If not, does the employer have to continue filing a Form 5500 until all participants incur a distributable event (i.e., termination of employment, age 59 1/2, death or disability)?

Proposed Response. Yes, upon the employer's termination of participation in the §403(b) plan, the individual participants can roll their account balances into an IRA. In Frank v. Aaronson, 120 F3d 10, the Court did not consider circumstances under which a plan termination had occurred. In the case of a plan termination, the eligible rollover distribution rules override the distribution requirements of Section 403(b)(7).

If the individual participant will not be allowed to roll over their account balances under the §403(b) plan until they incur a distributable event, the employer is no longer maintaining the §403(b) plan. The employer can file a final Form 5500 for the year of termination and no further Forms 5500 will be required.

IRS Response. The IRS disagrees with the proposed response. There has to be a distributable event. If there has not been a separation from service from the plan sponsor, the employees cannot receive rollover distributions. There is no "termination of plan" distributable event for §403(b) plans as there is for qualified plans.

19. §410(a) – Year of Service

Question. Assume that a participant takes a maternity leave in 1997 and returns that year. She worked more than 500 hours of service that year. In 1998, she quits after working less than 500 hours of service. Is she credited with the 500 hours of service for 1998 under the maternity leave rules even though her leave ended in 1997?

Proposed Response. No, the additional service credited on account of a period of maternity leave is only allocated to computation periods during which the participant is actually on maternity leave. Bridging the service into another year only occurs when the period of maternity leave begins in one year and ends in another.

IRS Response. The IRS disagrees with the proposed response. The IRS noted Treas. Reg. 1.410(a)-9 contains an example on point. If the participant doesn't need the hours to avoid a break in service during the year of maternity leave, the hours should be credited in the following year.

20. §411 – Participant Consent Requirements

Question. Is the non-availability of hardship distributions following termination of employment a "significant detriment" vitiating participant consent under §1.411(a)-11? Does it make any difference if the former employee could elect to receive an immediate distribution of his entire account balance at any time?

Proposed Response. No, the non-availability of hardship distributions following termination of employment is not a significant detriment for purposes of the participant consent rules. This is the case regardless of whether the former employee could elect to receive an immediate distribution at any time or not.

IRS Response. If a distribution is allowed at any time following termination of employment, there is no significant detriment imposed on the participant due to the inability to receive a hardship distribution. If a participant who does not consent to a distribution immediately upon termination of employment cannot receive a distribution until attaining normal retirement age, a significant detriment is imposed on the employee's refusal to consent to an immediate distribution at termination of employment.

21. §411 – Profit Sharing Plan Discontinuance

Question. A profit sharing plan is amended to add a cash or deferred arrangement under section 401(k) and an associated matching contribution. No further contributions are made to the regular profit sharing account that existed prior to the plan amendment. The employer does enjoy current profits. Has there been a "discontinuance " of the 401(a) portion of the plan that requires full vesting?

Proposed Response. No.

IRS Response. The IRS agrees with the proposed response. Whether a discontinuance has occurred is a facts and circumstances determination. Stopping one type of employer contributions while commencing employer contributions of another type is not a discontinuance of the plan requiring full vesting.

22. §411 – Cash out Distributions

Question. Can a plan require that a participant repay his §401(k) contributions that were distributed in addition to his company contributions that were distributed in a cash out distribution? What about after-tax employee contributions?

Proposed Response. Yes. There is no limitation that only the amounts subject to vesting must be recontributed by the participant in order to restore the forfeited benefit.

IRS Response. The IRS agrees with the proposed response.

23. §411 – Normal Retirement Benefit

Question. A pension plan provides that benefits shall be payable to a participant when the participant attains the normal retirement age. Because a participant failed to maintain a current address on file with the administrator (as required by the plan document), the participant is not located until 12 months after the normal retirement age. The plan commences monthly benefits when the participant is located and also pays a lump sum amount equal to the 12 months of missed payments. The plan document does not address the payment of interest on late payments.

A) The administrator pays no interest on the late payments pursuant to a committee rule that says that no interest will be paid where the late payment is due to an error by the participant. Is this acceptable?

B) The administrator pays interest at a rate specified by committee rules for late payments. Is this acceptable despite the absence of a provision in the document authorizing interest ?

Consider the same situation except that the late payment is due to the plan's administrative error. The committee rules provide that no interest will be paid on any late payments. Is this acceptable?

Proposed Response. All of the above are acceptable. It is within the plan's discretion to adopt a rule awarding or denying interest on late payments provided that the rule is applied to all similarly situated participants. Cf. DeVito v. Pension Plan of Local 819 IBT Pension Fund 20 EBC 2864 (S.D.N.Y. 1997)..

IRS Response. Section 411 requires that the benefit received by the employee be the actuarial equivalent of the normal retirement benefit. The distribution needs to reflect the time value of the delayed distribution. The IRS does not have precise guidelines on how that is to be accomplished, but the plan's operation must be reasonable.

24. §414(b) – Controlled Group of Corporations

Question. Item 4 of the Form 5500 asks if the plan is a single employer plan or a plan of a controlled group of corporation. How should this item be completed if the plan only covers a single corporation that is part of a controlled group of corporations?

Proposed Response. It should be treated as a plan maintained by a controlled group of corporations, because the qualification requirements are applied on that basis.

IRS Response. The IRS disagrees with the proposed response. The form should be completed indicating the plan is sponsored by a single employer. The IRS noted the 1998 Form 5500 is being revised and the new version should be released shortly.

25. §414(b) – Determination of Controlled Group

Question. Suppose a husband and wife each own companies that are not aggregated under the controlled group rules. If they subsequently have a child, it appears that the rules of attribution attribute each parent's ownership to the newborn with the result that the two companies become a controlled group under 414(b) or 414(c). Is this correct?

Proposed Response. Yes.

IRS Response. The IRS agrees with the proposed response.

26. § 414(1) – Transfers of Assets and Liabilities

Question. Treas. Reg. § 1.414(l)-1(d) provides that a merger of two or more defined contribution plans will satisfy the requirements of IRC § 414(l) if certain conditions are satisfied, one of which is that "the sum of the account balances in each plan equals the fair market value (determined as of the date of the merger) of the entire plan assets." The instructions to Form 5310-A also give this requirement as one of the conditions for not needing to file the Form for a merger of defined contributions plans.

If a defined contribution plan provides that forfeitures under the plan are held in suspense until used to reduce employer contributions, can the plan be merged with another defined contribution plan while any forfeitures are held is suspense? If yes, must a Form 5310-A be filed for the merger? In a large plan, it may be difficult to find a point in time that all suspended forfeitures have been applied against employer contributions.

Proposed Response. So long as the suspended forfeitures are applied against future employer contributions in the normal course of plan operations, the merger of the plans would be permissible, and the filing of Form 5310-A would not be necessary.

IRS Response. The IRS agrees with the proposed response. The Form 5310-A will be changed to explicitly reflect this response.

27. §414(p) – QDROs

Question. For purposes of applying the $5,000 threshold, is a distribution under a QDRO treated as a prior distribution?

Proposed Response. No. It was not a distribution to the participant, and the participant did not have any election rights with respect to the QDRO.

IRS Response. The IRS agrees with the proposed response. The distribution to an alternate payee is not a distribution to the participant, and does not trigger the participant consent rules for purposes of later distributions to the participant.

28. §415 – Early Retirement Reductions

Question. For purposes of adjusting any limitation under §415(b)(2)(C) or (D), to the extent that forfeiture does not occur upon death, the mortality decrement may be ignored prior to age 62 and must be ignored after SSRA. See Q&A G-3 and Q&A G-4 of Notice 83-10, 1983-1 C.B. 536.

Does this mean that there is no mortality charge in the pre-62 early retirement reduction if the retiree is on a 100% joint-and-survivor form? Is there only one-half of a charge if the form selected is a 50% joint-and-survivor? Does it matter whether it is a QJSA, which is generally disregarded for §415 benefit conversions, or an optional J&S with a non-spouse beneficiary? Does it matter whether the annuity benefit has been actuarially reduced to take into account the payment in J&S form? How does this work?

Proposed Response. None.

IRS Response. There is no required mortality charge for married participants who pay an administrative charge for a QPSA benefit. Unmarried participants do not have a death benefit, so there will be mortality adjustment.

29. §416 – Top-heavy plan

Question. Can the first year determination rule be used for the first year of any plan even if the plan sponsor maintains other plans? (At the 1997 ASPA annual conference, the Service responded that the first year rule is only available when there are no other plans in existence or required to be taken into account for purposes of the top-heavy determination. This position is not clearly evident from existing regulations.)

Proposed Response. None.

IRS Response. The IRS affirmed the answer given at the 1997 ASPA conference, which appears in Q&A 22 from that conference's question and answer session. If the plan sponsor has existing top-heavy plan, and later initiates a new top-heavy plan, the new plan is not considered a new plan for top-heavy valuation purposes.

30. §417 – Qualified Joint & Survivor Annuity

Question. If the beneficiary that is designated under an insurance policy was not approved in the manner consistent with §417, would that cause the plan to fail to satisfy the exemption from the applicability of the joint and survivor annuity rules where the payment is not to the surviving spouse?

Proposed Response. Yes. §401(a)(11)(B)(iii) requires that if any benefits must be paid to the surviving spouse, unless the spouse consents to the designation in a manner consistent with §417. The fact that portion of the participant's benefit is attributable to a life insurance policy does not change that result.

IRS Response. The IRS agrees with the proposed response.

31. §417 – Spousal Consent

Question. Can a surviving spouse demand that her survivor portion of the QPSA not become payable (following the participant's death) until such time as the participant would have attained age 62 if the amount of the benefit exceeds $3,500?

Proposed Response. Yes. Treasury Regulation §1.417(e)-1(b)(1) says that consent is not required after the benefit is no longer immediately distributable. However, until that time, spousal consent is required for the distributions to commence.

IRS Response. The IRS agrees with the proposed response.

32. §422 – Incentive Stock Options

Question. Can an employer issue an Incentive Stock Option ("ISO") to a person as an inducement for that individual to come to work for the corporation?

Proposed Response. No. ISOs can only be issued to employees, and the individual would not be an employee at that time. The ISO cannot become effective until the employee begins work.

IRS Response. The IRS agrees with the proposed response. The employer can agree to issue the ISO when the individual becomes an employee, but the date of grant in that case is the date the individual becomes an employee. See Treas. Reg. 1.421-1(b)(2) and (c)(3).

33. §457 – Government & Tax-Exempt Employer Deferred Compensation Plan

Question. §457 plans can accept a transfer only if the prior plan provides for an *automatic transfer*. Does this mean that the plan must automatically transfer the funds, even if the participant does not want to have his benefit transferred, or is it sufficient that the plan will automatically transfer it if the employee requests one?

Proposed Response. The participant can make the election; a rollover need not be automatic.

IRS Response. The IRS agrees with the proposed response.

34. §457 – Government & Tax-Exempt Employer Deferred Compensation Plan

Question. Can a distribution to a participant in a §457 plan as a result of an unforeseeable emergency include the taxes due on the distribution?

Proposed Response. Yes. The result should be same as under a §401(k) plan.

IRS Response. The IRS agrees with the proposed response.

35. §457 – Government & Tax-Exempt Employer Deferred Compensation Plan

Question. Does the restriction on in-service distributions contained in §457(d)(a)(A) apply to amounts transferred from another §457 plan?

Proposed Response. No. Because the participant could have had the distribution paid to him (rather than having it transferred to the current §457 plan), he or she should be able to receive it at any time.

IRS Response. The IRS disagrees with the proposed response. The in-service distribution restrictions do have to apply in the successor plan.

36. §457 – Government & Tax-Exempt Employer Deferred Compensation Plan

Question. §457(b)(4) provides that no amounts may be deferred for a month unless the deferral was entered into before the beginning of the month. Does this mean that if a participant elects to reduce his or her deferrals or cease making them altogether, that election cannot become effective until the first day of the following month?

Proposed Response. No. Only the original election must be made before the month. Participants can elect (on a prospective basis only) to reduce or cease their deferrals at any time.

IRS Response. The IRS generally agrees with the proposed response. There is a difference between the election to start deferrals and the election to stop deferrals.

37. §671 – Foreign trusts

Question. The change in the definition of foreign versus domestic trusts coupled with the requirement that a qualified plan use a domestic trust would seem to create problems where managers of foreign parent companies serve as trustees of the US qualified plan. Does the Service contemplate regulatory relief from this presumably unintended result, or should plan sponsors take steps to make changes in trustees? See proposed regulation 301.7701-7 Trusts — domestic and foreign.

Proposed Response. Absent a technical correction to the statute, plan sponsors should plan on modifying trustee responsibilities and control.

IRS Response. For a trust in existence on August 19, 1996 that was treated as a domestic trust on that date, section 1151 of Taxpayer Relief Act allows the plan to elect to continue treatment as a domestic trust, and Notice 98-25 provides guidance on plans eligible to make the election on the procedures to make the election.

38. §1042 – ESOP Rollovers

Question. Assume that a shareholder sold stock to an ESOP and elected §1042 treatment on the sale, so that the nonallocation rules of §409(m) apply. Assume further that before all of that stock was allocated, the employer was acquired by another employer in a stock-for-stock transaction. Would the nonallocation rules apply to the shares of the new employer's stock?

Proposed Response. None.

IRS Response. Even thought there is a corporate reorganization, the rules continue to apply.

39. §1441 – Nonresident alien withholding

Question. Recent final regulations on withholding requirements for nonresident aliens appear to require withholding for these individuals under section 1441 instead of under section 3405. What are the implications of this change for the qualification requirement to accommodate direct transfers of eligible rollover distributions? Does this mean that nonresident aliens are no longer eligible to roll distributions to an IRA or another qualified plan?

Proposed Response. None.

IRS Response. Notice 98-16 provides that the new regulations do not go into effect until 2000. Additiaonally, the new regulations require withholding on amounts that are income, and amounts directly rolled over are excluded from income.

40. §4975 – ESOPs

Question. Assume that an ESOP acquires stock in a leveraged transaction at $10 per share. Later, when the stock is valued at $20 per share, there is a stock split. For purposes of computing the net unrealized appreciation, what is the basis of (a) the original shares and (b) the additional shares acquired as a result of the stock split?

Proposed Response. The original basis of the shares is divided evenly among the shares held in the participant's account after the stock split.

IRS Response. The IRS agrees with the proposed response. Allocation is done on the basis of the number of shares pre and post stock split.