1. §83 — Transfer of Property in Conjunction with the Performance of Services

Can an employee file a §83(b) election with respect to the issuance of restricted stock as a result of the exercise of an ISO, so as to minimize the amount of income that must be recognized if the individual makes a disqualifying disposition of the ISO stock before the expiration of the holding periods and the stock has appreciated between the date on which the ISO was exercised and the date of the disqualifying disposition?

**Proposed Response.** No. Making a §83(b) election is fundamentally inconsistent with treating the option as an ISO. If the individual does not actually include the amounts in income, filing the §83(b) election has no effect.

**IRS Response.** The IRS agrees with the proposed result, but not because of the proposed reason. Section 83(e)(1) indicates §83 doesn’t apply to anything that §423 applies to, so a disposition of an ISO is outside the terms of §83.

2. §125 — Cafeteria Plans

In the case of prescription drugs purchased through a mail order pharmacy, when are the expenses incurred for purposes of determining their reimbursability under a cafeteria plan? It would appear that the relevant date is when the order was placed for the drugs.

**Proposed Response.** The general rule is that expenses are treated as incurred when the care is provided, not when the participant is billed, charged for, or pays the expense. Prop. Treas. Reg. 1.125-1, Q&A-17. Thus, the date on which the drugs were ordered is controlling.

**IRS Response.** The IRS indicated plan sponsors should be reasonable. The regulation might function as a safe harbor for determining the reasonableness of when an expense can be repaid.

3. §125 — Cafeteria Plan

Can a cafeteria plan impose a minimum age requirement?

**Proposed Response.** Yes. Although there is no reference to a minimum age requirement in §125, §125(g)(3)(A) states that a cafeteria plan that satisfies §410(b)(2)(A)(i) (i.e., a classification that does not discriminate in favor of highly compensated employees) will not be treated as discriminatory. Thus, if the class
of employees (after taking into account the minimum age requirement) satisfies §410(b)(2)(A)(i), it is acceptable.

**IRS Response.** The IRS agrees with the proposed response.

4. **§162(m) — Excessive Employee Remuneration**

Assume that the maximum number of shares that can be issued to an employee who is subject to §162(m) under the terms of the plan is limited to 500,000. Assume further that such an employee is granted an option to purchase 100,000 shares, which the employee lets lapse (because it is underwater). Is the maximum number of shares that can be granted to the individual after the lapse 400,000 or 500,000?

**Proposed Response.** 400,000. Treas. Reg. 1.162-27(e)(2)(vi) requires that the plan state "the maximum number of shares with respect to which options or other rights may be granted." It does not say the maximum number of shares that may be issued.

**IRS Response.** The IRS agrees with the proposed response.

5. **§ 401(a)(27)—Money Purchase Pension Plans**

Suppose that a defined contribution plan provides that each year (1) an amount equal to X percent of each participant’s compensation for the year will be allocated to such participant’s account, and (2) the plan sponsor will contribute to the plan an amount sufficient to make those allocations. Will the plan be a profit-sharing plan rather than a money purchase pension plan as long as it provides that it is intended to be a profit-sharing plan?

**Proposed Response.** Yes. A defined contribution plan is a profit-sharing plan if it provides that it is intended to be a profit-sharing plan. It is not necessary that contributions be discretionary or that allocations be based on factors other than compensation in order for a defined contribution plan to qualify as a profit-sharing plan.

**IRS Response.** The IRS agrees with the proposed response. Section 401(a)(27) no longer requires that contributions be contingent on profits.

6. **§401(a)(31) — Direct Rollovers**

An employer maintains both a qualified defined benefit plan and a qualified defined contribution plan. While the normal form of distribution from the defined benefit plan is a qualified joint and survivor annuity, a lump sum is offered as an optional form of benefit (assuming receipt of spousal consent where the participant is married). To promote portability and encourage departing
employees to preserve retirement assets in retirement plans, the employer is considering amending both the defined benefit plan and the defined contribution plan to provide that upon termination of employment and a participant's election of the lump sum form of distribution from the defined benefit plan, that former employee participant can elect a direct rollover of all or part of the lump sum amount into the former employer's defined contribution plan. Will the defined contribution plan continue to qualify under §401 where the plan accepts the direct rollover of a former employee's lump sum from that same employer's defined benefit plan?

**Proposed Response.** The former employer's defined contribution plan accepting the direct rollover of a former employee from that same former employer's defined benefit plan should not disqualify the former employee's defined contribution plan. The lump sum distribution from the defined benefit plan is an eligible rollover distribution under §402(f)(2)(A). Under §401(a)(31), the defined benefit plan must permit the former employee to elect a direct rollover to an eligible retirement plan. As long as the defined contribution plan has terms that permit the acceptance of rollover distributions as provided in §401(a)(31)(D), the former employer's defined contribution plan is an eligible retirement plan as defined in §402(c)(8)(B). Treas. Reg. 1.402(c)-2, Q&A-2 includes in the definition of eligible retirement plan "an employees' trust described in §401(a) which is exempt from tax under §501(a)" (emphasis added). It would be unnecessarily restrictive to interpret "employees' trust" as only permitting current employees the right to make direct rollovers into the trust. A better reading is that "employees' trust" is a plan that qualifies under §§401(a) and 501(a) that are established for all employees of the employer, both current and former. To the extent the plan sponsor is willing to permit both former employees as well as current employees to make direct rollovers into the sponsored defined contribution plan, former employees have the opportunity to preserve the retirement assets within retirement plans they feel they can trust based on their former and current relationship with the plan sponsor. In addition, the former employer's plan may offer features like loans and reduced transaction costs that may not otherwise be available to the former employee and provide an additional incentive to preserving the assets for future retirement benefits.

**IRS Response.** The IRS agrees with the proposed response. There is no reason the plan transactions described above could not occur assuming the defined contribution plan accepts rollover distributions.

7. **§401(b) Remedial Amendment Period**

Notice 96-64 extends the §401(b) period for TRA'86 amendments for government plans to the later of the last day of the 1999 plan year or the 1999 legislative year. Rev Proc 98-14 extends the §401(b) period for GATT/SBJA/TRA'97 amendments for government plans to the last day of the plan year beginning before 2001 but does not extend the §401(b) period for TRA'86 amendments for government
plans. Notice 98-39 extends the §401(b) remedial amendment period for TRA'86 amendments for church plans to the last day of the first plan year beginning on or after January 1, 2001.

Will the §401(b) remedial amendment period for TRA'86 amendments for government plans be extended to the same date that applies to GATT/SBJA/TRA'97 amendments for government plans.

**Proposed Response.** Yes.

**IRS Response.** The IRS noted that Rev. Proc. 99-23 extends the remedial amendment period for the Tax Reform Act of 1986 for government plans to be co-extensive with the Small Business Job Protection Act remedial amendment period.

8. **§401(k) Plan - Participation of Rehired Former Employee for Salary Deferral Purposes**

In the case of a rehired employee who satisfied a §401(k) plan's minimum age and service requirements before he terminated employment (whether or not such rehired employee actually became a participant in the plan before he terminated employment) and did not incur a one year break in service, must the §401(k) plan provide that such rehired employee be permitted to make §401(k) salary deferrals immediately on the date of rehire or may the plan impose a reasonable administrative delay before such rehired employee can make salary deferrals? Does it make any difference if the employee above incurred a one year break in service before being rehired and the plan requires the employee to complete one year of service upon rehire before crediting prior service for any purpose?

**Proposed Response.** Reg. 1.410(a)-4(b)(1) requires that if a former employee, who satisfied a plan’s minimum age and service requirements before he terminated employment, returns to service without incurring a one year break in service, the employee must commence participation immediately upon his return. This appears to require immediate participation for all plan purposes, including salary deferral contributions. On the other hand, it is administratively difficult to provide for such immediate salary deferrals and allowance of a brief administrative delay (such as until the first day of the next quarter after rehire date in a 401(k) plan with quarterly entry dates) seems reasonable in the circumstances.

Reg. 1.410(b)-4(b)(1) further provides that if an employee’s prior service is disregarded under the plan’s break in service rules, then the service is also disregarded for purposes of determining the date on which the employee first satisfied the minimum break in service requirements. While not entirely clear, it does not appear that this provision makes a difference in determining the date of required re-participation to be able to make salary deferrals.
IRS Response. The IRS agrees with the proposed response that it is administratively difficult to provide immediate participation in the §401(k) plan. However, the IRS did not agree that participation on the first day of the next quarter after rehire was reasonable, instead preferring participation after one or two pay periods.

9. §401(k)/(m) Plans - Prior Year Testing Method and Timing of Contribution of QNECs and QMACs

IRS Notice 98-1 provides that, under the prior year testing method, a QNEC or QMAC must be contributed by the end of the testing year in order to be taken into account in calculating the ADP or ACP for NHCEs for the prior year. For example, this guidance states that if the prior year testing method is used for the 1998 testing year, QNECs that are allocated to the accounts of NHCEs for the 1997 plan year (i.e., the prior year) must be contributed by the end of the 1998 plan year in order to be treated as elective contributions under the ADP test for 1998. Because the ADP or ACP testing for HCEs normally cannot be completed until after the testing year (i.e., early in 1999 in this example for a calendar year plan), how is this supposed to work? Is any relief contemplated to make this more workable?

Proposed Response. This timing requirement appears to be restrictive and impractical. The ADP or ACP testing for the HCEs cannot be completed until after the end of the plan year (1998 in this example) because the data is not available until after the year is closed, and variables such as election changes and personnel changes during the testing year could cause significant variation in the actual ADP or ACP testing from preliminary ADP or ACP testing for HCEs done before, or earlier in, the testing year. This means that the QNECs and QMACs cannot be calculated, much less contributed, by the last day of the testing year. Additional guidance should be issued extending the time period by which the QNECs or QMACs must be contributed.

IRS Response. The IRS disagrees with the proposed response. IRS guidance indicates that if a plan is using prior year testing to satisfy the ADP test, QNEC contributions must be made during the year. This is considered one of the trade-offs for the ability to use prior year testing.

10. §401(k) Plan Safe Harbors - Plan Amendments

Section X.I. of Notice 98-52 states that a plan must specify whether it is using the ADP/ACP tests, the safe harbor provisions, or the SIMPLE 401(k) plan formula and that generally a plan sponsor that intends to use the safe harbor provisions for a plan year must adopt those provisions before the first day of the plan year (there’s a special rule for the remedial amendment period for the plan year beginning in 1999). Once you get beyond the period covered by the remedial amendment period special rule, does this mean that a plan sponsor that chooses to
switch from using the matching contribution safe harbor for one year (for example, the 2000 plan year) to the nonelective contribution safe harbor for the next plan year (the 2001 plan year in this example) must amend the plan to specify that choice before that next plan year (the 2001 plan year in this example) begins?

Proposed Response. While not entirely clear from the guidance in Notice 98-52, it appears the plan amendment must be adopted before that next plan year (2001 in this example) starts. In addition to the guidance in section X.I. of Notice 98-52, Section V.B.1. requires that the terms of the plan require that the safe harbor matching contributions under either the basic matching formula or an enhanced matching formula are required to be made for eligible NHCEs. See also section VI.B.4.a. Similarly, section V.B.2. requires that the plan terms require the employer to make the safe harbor nonelective contribution on behalf of each eligible NHCE.

IRS Response. The IRS agrees with the proposed response, except for the portion of the proposed response that indicates the answer is not clear in Notice 98-52. An employer that wants to use the safe harbor needs to include that provision in the plan document.

11. §401(k) — Cash or Deferred Arrangements

How is severance pay treated for purposes of eligible plan compensation for §401(k) elective deferrals, plan contributions in general, and additional accrual of service? Does it matter whether severance pay (or a final "bonus") is paid before, on, or after the last day of active employment?

Proposed Response. In order to facilitate the use of the safe-harbor definition of compensation based on Box 1 of an employee's W-2, severance pay which is W-2'd to the employee or former employee for the plan year of termination may be counted as plan compensation and counted as benefit service, regardless of how denominated or when it is actually paid. A plan document may specifically make this clear or provide otherwise, and/or a plan administrator with power to interpret the plan's terms may specifically make this clear or provide otherwise.

IRS Response. The IRS disagrees with the proposed response, but noted they are not vigorously pursuing enforcement of this policy. The IRS indicated the deferral must come from compensation paid to an employee, not other amounts paid to former employees. If plan sponsor do want to allow deferrals from severance compensation, a specific plan provision to that effect would provide reliance.

12. §401(k) — Cash or Deferred Arrangements

If a §401(k) plan flunks the ADP test, the amount to be refunded no longer is related to the employee whose deferral percentage is the greatest. Does this
change regarding refunds preclude a §401(k) plan from reducing contributions by highly compensated employees during the plan year (on a prospective basis) on the basis of the highest deferral percentage?

**Proposed Response.** No. The rule only governs refunds; it does not apply to prospective reductions during a plan year.

**IRS Response.** The IRS agrees with the proposed response. This result is what is intended by prior year testing. The plan sponsor knows the limits near the beginning of the plan year and limits HCE deferrals accordingly.

13. **§401(k) — Cash or Deferred Arrangement**

Are §401(k) contributions treated as employee or employer contributions for purposes of the incidental death benefit requirements applicable to life insurance?

**Proposed Response.** They are treated as employee contributions. The determinative factor is whether the employee is voluntarily making the contribution, not whether it is made in pre-tax or after-tax dollars.

**IRS Response.** The IRS strongly agrees with the proposed response. Treas. Reg. 1.401(k)-1(a)(4)(ii) clearly indicates elective deferrals to a §401(k) plan are treated as employer contributions for a variety of Code provisions, including the incidental death benefit requirement.

14. **§401(k) — Distribution Upon Sale of Subsidiary**

For purposes of §401(k)(10)(A)(iii), what constitutes a "subsidiary"?

**Proposed Response.** For such purposes, subsidiary would include a "controlled" (within the meaning of §414(b) and (c)) corporation or partnership.

**IRS Response.** The IRS agrees with the proposed response regarding a corporation, but disagrees that a partnership would be considered a subsidiary for these purposes. A partnership or other limit liability form of business that has elected to be taxed as a corporation under the "check-the-box" regulations would be considered a corporation for these purposes.

15. **§401(k) — Cash or Deferred Arrangement**

According to Treas. Reg. 1.401(k)-1(d)(3), a §401(k) plan may not distribute elective contributions to participants upon plan termination if another defined contribution plan (other than an ESOP or SEP) is established or maintained by the employer within 12 months of the plan termination. Is a 403(b) plan a successor defined contribution plan for these purposes?
Proposed Response. No, a §403(b) plan is not a successor plan for purposes of Treas. Reg. 1.401(k)-1(d)(3). At the time that the final §401(k) Treasury regulations were issued in 1991, a tax-exempt entity could not maintain a §401(k) plan, unless grandfathered. Since it seems highly unlikely that a tax-exempt entity would maintain both §401(k) and §403(b) plans, §403(b) plans were left out of the defined contribution plan exclusion (i.e., ESOP or SEP).

IRS Response. The IRS agrees with the proposed response. A §403(b) plan is not an individual account plan for precluding distributions under the successor plan rule. The point of the successor plan rule is that distributions should not be permitted if there is another plan that can serve as a repository for the §401(k) funds. That is not possible with a §403(b) plan, because §401(k) distributions cannot be rolled over into a §401(k) plan.

16. §401(k) — Cash or Deferred Arrangement

Section 401(k)(2)(B)(i)(IV) refers to a "profit sharing or stock bonus plan to which §402(e)(3) applies." §402(e)(3) simply states that an employee is not in constructive receipt of amounts contributed to the plan on his or her behalf pursuant to §401(k). What is the effect of including the reference to "to which §402(e)(3) applies?"

Proposed Response. None. It is superfluous.

IRS Response. The IRS disagrees with the proposed response. §402(e)(3) only applies to elective deferrals, and only permits hardship distributions of elective deferrals, not the earnings or related amounts.

17. §401(m)(11) — Safe Harbor Requirements

Neither IRS Notice 98-52 nor the safe harbor provisions of §401(m)(11) mention after-tax contributions. If an employer adopts the ACP Safe Harbor rules under IRS Notice 98-52, the employer is not permitted to make any matching contributions in excess of the matching contributions prescribed under the safe harbor rules. Is the plan also required to accept no after-tax employee contributions?

Proposed Response. After-tax employee contributions do not have to be restricted to comply with the ACP safe harbor rules because there is no reference to after tax contributions in §401(m)(11).

IRS Response. The IRS agrees with the proposed response. The IRS noted that Notice 98-52 uses the terms from the regulations, referring to after-tax employee contributions as employee contributions. The Notice clearly indicates employee contributions should be tested separately from the matching contributions.
18. § 402—Employee Contributions

Suppose that a company requires employees to elect to contribute a portion of their salaries to its profit-sharing plan as a condition of employment. Are such contributions employee contributions for purposes of §402?

**Proposed Response.** No. Such an election is a one-time irrevocable election within the meaning of Treas. Reg. 1.401(k)-1(a)(3)(iv). According to Treas. Reg. 1.402(a)-1(d)(2)(iii), contributions pursuant to a one-time irrevocable election are not treated as employee contributions.

**IRS Response.** The IRS disagrees with the proposed response. The reporting of the contribution controls whether the amount is treated as a employer or employee contribution.

19. §402 — Taxation of Distributions

PLR 9833016 holds that a participant in an ESOP is not taxed on the exchange of stock held in his account in exchange for another class of stock pursuant to §1036. Isn't the applicability of §1036 irrelevant, in that under §402, participants are only taxed upon actual distributions from the ESOP pursuant to §402? Similarly, aren't the basis rules determined pursuant to §402?

**Proposed Response.** Yes, §402 governs on all of the relevant issues.

**IRS Response.** The IRS agrees with the proposed response that §402 governs all relevant issues, but noted that the PLR appears to consider an ISO, not an ESOP.

20. §402 — Net Unrealized Appreciation

Does the IRS still agree with the conclusion in PLR 9424067 (March 23, 1994) that the net unrealized appreciation ("NUA") is lost in a direct rollover of benefits between plans maintained by the same employer, when it is clear that a trustee-to-trustee transfer preserves the NUA?

**Proposed Response.** No. There is no justification in the disparate treatment where both plans are maintained by members of the same controlled group of corporations.

**IRS Response.** The IRS disagrees with the proposed response. The PLR still reflects the IRS position. The direct rollover should have the same treatment as a normal rollover, which also eliminates NUA treatment on later distributions from the rollover plan.

21. §404 — Deduction of Contributions
Assume Defined Benefit Plan A covers the employees of Employer X, a for-profit corporation and Organization Y, a tax-exempt organization. Both Employer X and Organization Y comprise a single controlled group. For the 1999 plan year, the tax-deductible limit for Plan A is calculated to be $10 million.

Can Employer X contribute and deduct the entire contribution on behalf of the controlled group?

**Proposed Response.** No. The maximum deductible amount for Plan A must be allocated among the participating employers. The maximum deductible limit can be allocated in proportion to the different employers payroll or using more detailed valuation results. Employer X can get a deduction for the lesser of its deductible limit or the amount that it actually contributes to the plan.

**IRS Response.** The IRS agrees with the proposed response, but noted that allocating the deduction according to relative payrolls may not be appropriate if the benefit is unrelated to payroll.

22. **§408 — Individual Retirement Arrangements**

Can an IRA invest in a life insurance contract by investing in a partnership, the sole function of which is to purchase the life insurance?

**Proposed Response.** No. Section 408(a)(3) prohibits investing IRA funds in life insurance. It does not matter whether the investment is made directly or indirectly.

**IRS Response.** The IRS agrees with the proposed response. An IRA cannot own a life insurance contract, either directly or indirectly.

23. **§409(e) — ESOP Voting Rights**

Assume that an ESOP owns stock in a privately held corporation that is part of a "roll-up" initial public offering of stock. (i.e., the shareholders of each corporation will receive shares of a new publicly traded corporation, which is the amalgamation of several previously unrelated corporations, in exchange for the shares that they currently hold.) Can the ESOP pass-through voting rights rules of §409(e)(3) be avoided simply by calling the transaction a "exchange offer" instead of a type of transaction specified in §409(e)(3)?

**Proposed Response.** No. It is the substance of the transaction that counts, not the label that is applied to it.

**IRS Response.** The IRS agrees with the proposed response. The substance of the transaction controls the treatment.

24. **§410(b) — Average Benefits Test**
Employer sponsors a profit sharing plan with §401(k) pre-tax contributions, §401(m) after-tax contributions, §401(m) matching contributions, and profit sharing allocations based on compensation. In performing the average benefit percentage test, does the employer include pre-tax elective deferrals?

**Proposed Response:** The regulations seem to imply that they are not included. Treas. Reg. 1.401(k)-1(b)(4)(ii) says deferrals are generally treated as employer contributions but then lists those sections (by example) that this rule applies to, with §410 not included. Treas. Reg. 1.410(b)-5(d)(2) excludes "employee contributions" from the average benefit percentage test, and §1.410(b)-5(d)(5) refers to §401(a)(4) regulations for the calculation of the actual benefit percentage. Treas. Reg. 1.401(a)(4)-(1)(a)(7) requires the plan to disregard "employee-provided contributions" and references (b)(2)(ii)(B) for rules applicable to employee contributions allocated to separate accounts. That paragraph refers only to 401(k) and 401(m) plans and indicates that a 401(k) plan is deemed to satisfy 401(a)(4) if the elective contributions satisfy 401(k) and a 401(m) plan is deemed to satisfy 401(a)(4) if the plan satisfies 401(m). Therefore, if the 401(k) plan satisfies §401(k), the elective contributions should be excluded from the §410(b) calculation of the average benefit percentage.

However, this result is clearly at odds with the legislative history of the average benefits test and conflicts with the regulatory provision that §401(k) plans are included in the testing group for purposes of the average benefits percentage test. The General Explanation of the Tax Reform Act of 1986 (the "Blue Book"), page 673, indicates that

> For purposes of determining benefit percentages [for the average benefits percentage test], all pre-tax contributions or benefits provided under a qualified plan are considered employer-provided and are to be taken into account, including, for example, elective deferrals under a qualified cash or deferred arrangement (sec. 401(k)).

Additionally, Treas. Reg. 1.410(b)-7(e)(1) indicates that the testing group for the average benefits percentage test is determined by applying the rules of plan disaggregation without regard to Treas. Reg. 1.410(b)-7(c)(1), the disaggregation rule for §401(k) plans. Since Treas. Reg. 1.410(b)-9 defines a §401(k) plan as consisting of elective contributions to a qualified cash or deferred arrangement, such amounts are considered in performing the average benefits percentage test.

**IRS Response:** The IRS agrees with the last paragraph of the proposed response. §401(k) plans are treated as defined contribution plans for purposes of the average benefits percentage test, and elective deferrals are considered in determining the employee benefit percentage.

25. §410(b) — Mandatory Disaggregation
The Instructions to Schedule Q of Form 5310 provide that a plan is not considered to be mandatorily disaggregated if the plan contains a §401(k) plan and another plan, or a §401(m) plan and another plan. What if the plan has both a §401(k) and §401(m) feature?

**Proposed Response.** The plan should be mandatorily disaggregated.

**IRS Response.** The IRS disagrees with the proposed response. The §401(k) and §401(m) features are not disaggregated when completing the Schedule Q, even if the features cover different employee populations (such as if the matching contribution is provided to one group covered by the plan but not another). There are other rules that take into account separate testing of the plans, but that’s not reflected on the Schedule Q.

26. **§410(b)(6)(C) — Coverage Testing After Acquisition or Disposition**

Employer S maintains a defined contribution Plan S prior to a stock acquisition by Employer P. Plan S satisfies the coverage and non-discrimination tests, but has other administrative or qualification problems that leads Employer P to insist on termination of Plan S immediately before the acquisition date. Either a new plan is established for employees of S shortly after the acquisition date, or an existing Plan P is extended to those employees. In either case, the allocations and coverage applicable to employees of S are identical to those that existed under Plan S prior to the acquisition. Can the newly-established plan (or the component plan within Plan P) take advantage of the transition rule in §410(b)(6)(C)?

**Proposed Response:** Yes, so long as the other conditions of §410(b)(6)(C) are satisfied. Code §410(b)(6)(C) states that the requirements of §410(b) "shall be treated as having been met" during the transition period with respect to any plan covering members of the controlled group if the requirements were met immediately before the transaction and if "the coverage under such plan is not significantly changed during the transition period (other than by reason of the change in members of the group)." The newly-established plan (or a disaggregated portion of Plan P equivalent to the prior plan) can be treated as a successor plan to (or can be aggregated with) Plan S, and should therefore be able to rely on the ability of Plan S to satisfy the requirements of §410(b) prior to the transaction.

**IRS Response.** The IRS disagrees with the proposed response. The 410(b)(6)(C) protection applies in situations where the plan is essentially unchanged but the demographics of the plan are changed. If the employer changes the plans or sets up new plans, the plan sponsor will need to comply with the normal coverage rules.

27. **§410(b)(6)(C) — Coverage Testing After Acquisition or Disposition**
Assume that an employer has recently acquired another company, so that it is still within the transitional period during which it does not have to take into account those individuals for purposes of testing whether the acquiror's plan satisfies §410(b). Unfortunately, the Form 5300 does not have an express category of exclusions for these individuals. Should they be treated for this purpose as ineligible to participate because of not having satisfied the age and service conditions?

**Proposed Response.** Yes.

**IRS Response.** The IRS agrees and disagrees with the proposed response. The acquired employees should be excluded on the Form 5300, but not because of the minimum age and service requirements. The employees should be excluded under snapshot testing or by noting the use of 410(b)(6)(C) on the form.

28. §411 — Normal Retirement Benefit

A plan discovers that a terminated participant now age 67 should have started receiving monthly benefits at age 65 (normal retirement age), payable as a single life annuity. The administrator immediately commences monthly payments that are actuarially increased to reflect the late commencement so that the benefit is an actuarial equivalent of the benefit payable at age 65. The plan makes no make up payments for the benefits that should have been payable from age 65 to age 67. The participant, who is terminally ill, demands back payments for the prior two years plus interest. Is the administrator’s action acceptable?

**Proposed Response.** No. The monthly benefits for the period from age 65 to age 67 are due and payable and offering an actuarially increased benefit starting at age 67 is not a substitute for these prior monthly payments.

**IRS Response.** The IRS agrees with the proposed response. Treas. Reg. 1.401(a)-14(d) specifically talks about a retroactive payment to the participant.

29. §411(a) — Change in Vesting Schedule

Where a vesting schedule changes from a more accelerated schedule to a less accelerated schedule, what is the vested status of a participant with less than three years of service. For example, assume the change is from a six year graded schedule (20% vested after two years of service) to a five year cliff schedule.

**Proposed Response.** As the participant in question has less than three years of service, the participant could not elect to remain under the six-year graded schedule. However, the participant must remain at least 20% vested in both his existing account and with respect to future contributions until the participant has completed 5 years of service, and then the participant will become 100% vested.
30. §411 Rule of Parity and §401(k) Plans

A participant in a §401(k) plan has an account balance that consists of elective deferrals and matching contributions. Matching contributions are subject to a five-year cliff vesting schedule. The participant terminates employment after three years of service. She returns to employment after six consecutive one-year breaks in service. Can her pre-break years of service be disregarded under the rule of parity, as described in §410(a)(5) and §411(a)(6)?

Proposed Response. No. The rule of parity only applies to "nonvested participants." A nonvested participant is defined as a participant who does not have any nonforfeitable right to an accrued benefit derived from employer contributions. Elective deferrals under a §401(k) plan are treated as employer contributions. Treas. Reg. 1.401(k)-1(a)(4). The employee is not a "nonvested participant" within the meaning of Sections 410(a)(5)(D)(iii) and 411(a)(6)(D)(iii).

IRS Response. The IRS agrees with the proposed response.

31. 411(d)(3) — Partial Plan Termination

When a money purchase pension plan is converted to a profit-sharing plan, will the participants be required to be 100% vested in their accounts under the money purchase plan?

Proposed Response. No.

IRS Response. The IRS agrees with the proposed response, but noted that Rev. Rul. 94-76 requires the money purchase pension characteristics of the participant’s benefits must be maintained if the account balances remain in the plan.

32. §411(d)(6) — Protection of Benefits

Treas. Reg. 1.411(d)-4, Q&A 10(b)(1) (pertaining to the elimination of an age 70_ distribution option as a result of the statutory change to I.R.C. § 401(a)(9)) provides an exception permitting the elimination of the age 70_ option if the amendment eliminating the option applies "only to benefits with respect to employees who attain age 70_ in or after a calendar year, specified in the
amendment, that begins after the later of (i) December 31, 1998; or (ii) the adoption date of the amendment."

Does this provision mean that, regardless of the plan’s operational procedures, if the formal plan amendment eliminating the age 70 distribution provision from the plan is not made until sometime in 1999, the effective date of the elimination of the option cannot be before January 1, 2000?

**Proposed Response:** One literal reading of the regulation may require a January 1, 2000 effective date since that is the first day of the calendar year that begins after the later of December 31, 1998, or the adoption date of the amendment (in 1999). However, this result is viewed by some as contrary to the general approach that has been used with respect to compliance amendments which is that the plan operates in accordance with the new law and documents such operations by a plan amendment adopted before the end of the remedial amendment period. Many employers assumed that they could utilize a January 1, 1999 effective date for the elimination of the age 70 distribution option and document such effective date at the same time as they made other plan amendments prior to the end of the remedial amendment period (December 31, 1999 for calendar year plans).

**IRS Response.** The IRS noted that they say what they mean and mean what they say. Plans have until the end of the plan year beginning in 2000 to be amended, but any amendment eliminating the age 70 distribution provision must be adopted prospectively.

33. §411(d)(6) — Protection of Benefits

An employer maintains both a qualified defined benefit plan and a qualified defined contribution plan. While the normal form for distribution from the defined benefit plan is a qualified joint and survivor annuity, a lump sum is offered as an optional benefit form. In addition, the employer is considering amendments to both its defined benefit plan and its defined contribution plan to permit participants to elect while still employed to transfer their defined benefit lump sum to their account in the defined contribution plan, such election to become effective upon termination from employment. Assuming the election is not given effect until the benefit in the defined benefit plan is otherwise distributable (e.g. after the employee has terminated employment) and any affected married participants obtain the appropriate spousal consent, would the implementation of the proposed amendment adversely affect the qualification of either plan or cause the defined contribution plan to have to be amended to add all of the section 411(d)(6) protected rights and features that are a part of the defined benefit plan?

**Proposed Response.** The concept of giving a plan participant the option to transfer their benefit between plans is not a novel idea. For example, Rev. Rul. 67-213 recognized this possibility when describing an employer that gave its employees the right to transfer their benefit in a pension plan to a stock bonus.
plan. While the ruling did not address whether this election was extended to retirees, an election such as this should not present a qualification problem just because it is not implemented until after the employee has terminated employment. The 411(d)(6) regulations sanction elective transfers by employees between different types of plans. These regulations not only sanction elective transfers but otherwise protected benefits, rights, and features may be waived by an employee provided the conditions in Treas. Reg. 1.411(d)-4, Q&A -3(b) are satisfied. There should not be a different result just because the employee makes the transfer election prior to being eligible for a distribution. In addition, there should not be a different result just because the employee's transfer election is not given effect until after the individual has terminated employment when the benefit is distributable because in most cases benefits will not be distributable until such time. Furthermore, elective transfers to other qualified plans should be encouraged since it tends to preserve the benefit for retirement.

**IRS Response.** The IRS disagrees with the proposed response. A qualified plan cannot request a participant’s benefit election prior to the distributable event. 417 requires a benefit election be within 90 of the annuity starting date, so contemporaneous elections are required.

34. §411(d)(6) — Protection of Benefits

Due to a merger of two companies, it is desired that two §401(k) profit sharing plans be merged. Plan A offers annuities and contains the full "QJA/QPSA/spousal consent" requirements of §417. Plan B has no annuity distribution option and only requires spousal consent on beneficiary designations as required by §401(a)(11)(B)(iii). Is there a cutback in benefits/§411(d)(6) issue if:

a. The ongoing merged plan extends the annuity option as the "normal" form to all participants (and with respect to all plan monies, new and old, from both Plan A and Plan B) and requires former Plan B participants to obtain spousal consent on distributions and loans on both new and old monies, or
b. The ongoing merged plan retains an annuity option as an optional form for all participants but utilizes §401(a)(11)(B)(iii) on all monies (both new and old) so that participants only have to have spousal consent on beneficiary designations and if a distribution is requested in the form of an annuity?

Note that the computer/accounting limitations of many of the largest plan providers and recordkeepers do not allow plans to try to segregate out old monies and apply different distribution options.

**Proposed Response.** The ongoing plan may utilize either option a or b above. Under option a, in light of Congress’ statement of public policy in favor of protecting spouses in the Retirement Equity Act, there is no cutback (even though...
a spousal consent requirement now applies to monies which previously would have been distributable without spousal consent). Under option b, since participants are still able to elect to receive their monies in the form of an annuity, the plan’s utilization of §401(a)(11)(B)’s exception to the spousal consent requirements is not a cutback (even though Plan A did not previously utilize this exception).

**IRS Response.** The IRS agrees with the proposed response. It is not a 411(d)(6) when a plan that did not have spousal consent requirements adds such requirements to existing benefits under the plan. The IRS no longer views having a joint and survivor benefit as the normal or default form of distribution as a default election of an annuity benefit, so eliminating the spousal consent requirements for all distributions is not a §411(d)(6) cutback.

35. **§ 411(d)(6)—Employer Discretion**

Would an early retirement window program similar to the program described and approved in McNab v. General Motors (7th Cir. 1998), which gave the plan sponsor the right to choose according to its "best interest" whom to cover under the program, satisfy the requirement in Treas. Reg. § 1.411(d)-4, Q&A-4, that Code § 411(d)(6) protected benefits not be subject to employer discretion?

**Proposed Response.** Yes. Nothing in Code § 411(d)(6) or the regulations thereunder prohibits an employer from exercising discretion with respect to coverage under a plan.

**IRS Response.** The IRS strongly disagrees with the proposed response. Employer discretion is not permitted in the operation of a window benefit. An employer has discretion in amending the plan and determining who is eligible for the window.

36. **§415 — Limitations on Benefits, Definition of Compensation**

Treas. Reg. 1.415-2(d)(11) provides for a safe harbor definition of compensation that corresponded to amount reported on Box 10 of the Form W-2. T.D. 8361 (09/19/1991). However Box 10 of the 1998 Form W-2 refers to Dependent Care Benefits. What, if anything, is the current referent on the Form W-2?

**Proposed Response.** None. It no longer exists.

**IRS Response.** The IRS disagrees with the proposed response. IRS forms change all the time, and the regulations are drafted to refer to the Code sections requiring wage reporting rather than to a specific box on a form. The safe harbor definition of compensation still exists, with compensation referred to in Treas. Reg. 1.415-2(d)(11) is now reported in Box 1.

37. **§415(e) — Repeal of Combined Plan Limits**
The Small Business Job Protection Act of 1996 repealed §415(e) effective for plan years beginning in 2000. This section limits the benefits that can be provided to any one individual under both a defined contribution and defined benefit plan using a fractional formula. Repeal of this section could be a significant step toward simplification of qualified plan administration if implemented in the proper manner.

Many plans provide for automatic increases in the §415(b) limitation. Absent any guidance from the IRS concerning implementation of the repeal of §415(e), plan sponsors who also sponsor nonqualified plans have been forced, in many situations, to guess how the statutory repeal will be applied to current retirees and terminated vested participants (i.e., whether the nonqualified plan can provide a similar provision for §415(e)).

In many cases, the qualified defined benefit payment is paid as an annuity while the nonqualified benefit is paid as a lump sum.

Since many of the nonqualified plans simply take up where the qualified plan left off, the plan sponsor must make an assumption whether the repeal of §415(e) will affect benefits paid to participants who are already retired or who have terminated vested benefits. If the plan sponsor assumes that the benefits of retired and/or terminated vested participants will automatically bump up to reflect no limitations by §415(e), or some pro-rata increase because of the repeal, the lump sum benefit from the nonqualified plan will be reduced accordingly.

If the plan sponsor assumes no change will be made to reflect the repeal of §415(e) for retired or terminated vested participants, the nonqualified lump sum benefit will be larger. If the plan sponsor guesses wrong, the participant will receive either too much or too little from the nonqualified plan and the resulting FICA tax will have been overpaid or underpaid.

What effect should the repeal of §415(e) have on (a) active employees, (b) employees who retire prior to January 1, 2000, and (c) terminated vested participants who terminated employment prior to January 1, 2000 (assuming a calendar year plan)?

**Proposed Response.**

a. §415(e) limitations should not be considered in any way in determining the benefits of an employee still active on January 1, 2000.

b. Plan sponsors should be allowed to choose, on a plan-wide basis, whether §415(e) will be applied to the benefits of participants who retired prior to January 1, 2000 (so that plan sponsors can match the assumption made for the nonqualified benefit). In the alternative, the IRS could require the increased benefit for nonhighly compensated employees but allow a plan-wide choice for highly compensated employees.
c. Same as (b).

**IRS Response.** The IRS noted that guidance on the repeal of §415(e) should be issued shortly.

### §415 — Limitation on Benefits

How are the limitations on benefits determined for employees that transfer between tax-exempt and for-profit organization that are part of the same controlled group? For example, assume a controlled group includes both tax-exempt Organization A and for-profit Employer B, and maintains separate qualified defined benefit plans covering each entity’s employees. What is the maximum benefit allowed under §415 for an employee who transfers from Employer B, and Employer B’s defined benefit plan, to Organization A and Organization A’s defined benefit plan?

**Proposed Response.** Since the §415 limits apply on a plan by plan basis, Organization A’s defined benefit plan can use the special limits of §415(b)(2)(F), while Employer B’s plan cannot. If Organization A’s plan grants past service credit for all service with the controlled group and coordinates benefits with Employer B’s plan, Organization A’s plan should be able to provide benefits based on past service using the rules of §415(b)(2)(F), and then reduce those benefits by the amount of benefits provided by Employer B’s plan, which are determined without regard to the rules of §415(b)(2)(F).

**IRS Response.** The IRS agrees with the proposed response.

### §415 — Limitation on Benefits

Effective in 1998, the definition of §415(c)(3) compensation is increased to include elective deferrals and salary reduction contributions under §§125, 401(k), 403(b), and 457 plans. How is this new definition used for years before 1998 when calculating the high 3-year average compensation under §415(b)(1)(B)?

**Proposed Response.** The old definition of §415(c)(3) compensation applies when determining compensation for years prior to 1998, even when compensation for such years is used to determine the §415 limit on benefits payable in 1998 and later. For example, if a participant’s high 3-year average compensation used to limit benefits payable in 1999 consisted of compensation from 1999, 1998, and 1997, elective deferrals and salary reduction contributions should be included in 1999 and 1998 compensation, but excluded from 1997 compensation.

**IRS Response.** The IRS agrees with the proposed response.

### §415 — Limitation on Benefits
Is a 50% joint and survivor annuity with a "pop-up" feature, so that the actuarial reduction is eliminated and the benefit increases if the spouse predeceases the participant, a qualified joint and survivor annuity (QJSA) for §415 purposes?

**Proposed Response.** Since the benefit satisfies the requirements for a QJSA specified in 417(b), the presence of an additional feature, such as a pop-up, does not preclude the benefit from being considered a QJSA. Because the pop-up is an integral part of the QJSA benefit, no adjustment to the §415 limit is needed for the value of the pop-up feature.

**IRS Response.** The IRS agrees with the proposed response. The pop-up feature does not prevent the benefit from being a QJSA, either for §417 or §415 purposes.

41. §416(c)(2)(A) - Compensation For Top Heavy Contributions

The definition of compensation for §415 purposes has been amended effective with the 1998 plan year to include elective deferrals and salary reduction contributions under §§125, 401(k), 403(b), and 457 plans. The definition of compensation for top heavy plan minimum contributions and benefits refers back to the definition of §415 compensation. Does this result in an increase in top heavy minimum contributions and benefits for 1998 and later years?

**Proposed Response.** Top heavy minimum contributions are increased for 1998 and later years. Top heavy minimum benefits that accrue in 1998 and later years are increased, but the old definition of §415 compensation can still be applied to top heavy minimum benefits that accrued in years prior to 1998.

**IRS Response.** The IRS agrees with the proposed response. The increase in the definition of §415 compensation will implicitly increase the top heavy minimum contribution.

42. §416(c)(2)(A) - Compensation For Top Heavy Contributions

For a plan that has a midyear entry date, are top heavy minimum contributions required to be calculated on the basis of the total compensation of the plan year of entry or only on the basis of the portion of the plan year during which the participant was a participant? Is the reference to compensation within the meaning of §415 that appears in §416(c)(2)(A) a reference to the definition of compensation that appears in Treas Reg 1.415-2(d) or does it also include the annual addition calculation rules that appear in Treas Reg 1.415-6 and in particular, the rule that appears in Treas. Reg. 1.415-6(a)(3)?

**Proposed Response.** The reference to §415 that appears on §416(c)(2)(A) refers to the definition is Treas. Reg. 1.415-2(d) but does not include the rules that appears in Treas. Reg. 1.415-6(a)(3) and does not require top heavy minimum
contributions to be made on the basis of compensation for periods before a new entrant became a plan participant unless the plan provides otherwise.

**IRS Response.** The IRS disagrees with the proposed response. Treas. Reg. 1.416-1, M-7 indicates that all the plan year compensation is used to determine the top heavy minimum.

### 43. §417 — Qualified Joint and Survivor Annuity Requirements

Assume that a defined benefit plan permits an employee under age 35 (whose spouse is also under age 35) to elect to waive the QISA and QPSA attributable to voluntary employee contributions, and instead, to receive a refund of those amounts. Assume further that the employee’s and spouse’s consent to the distribution of voluntary employee contributions is obtained in accordance with applicable law. Treas. Reg. 1.401(a)-20, Q&A-33(b) says that the spouse must again waive the QPSA after the spouse reaches age 35, or the benefit must be paid in that form. What happens if the spouse does not consent, but the refund has already been paid?

**Proposed Response.** This requirement only applies where the benefit has not already been paid. If the benefit (*i.e.*, the refund of the employee contributions) has already been paid, there is no reason to require that the spouse consent again to the waiver.

**IRS Response.** The IRS agrees with the proposed response, but noted that if a new benefit has been accrued since the distribution or any benefit remains in the plan, a new spousal waiver would have to be obtained.

### 44. §422 — Incentive Stock Options

Assume that an option labeled an ISO is granted to an independent contractor. Does the fact that the optionee is not an employee simply cause the option to be treated as a nonqualified stock option, or does that cause it to fail to be an option at all?

**Proposed Response.** That is not a question governed by the Code; rather the determination of whether the option is treated as being outstanding is governed by state law.

**IRS Response.** The IRS disagrees with the proposed response. The fact that optionee is not an employee makes the option a nonstatutory stock option. See Treas. Reg. 1.422A-2(a)(1)(ii).

### 45. §422 — Incentive Stock Options
In PLR 9531031, the IRS upheld the use of an evergreen provision in an ISO plan, despite the language in Proposed Treas. Reg. 1.422A-2(b)(3)(ii). Does that PLR represent the position of the IRS, or is it an aberration? If the conclusion is PLR 9531032 is correct, would it apply to a Employee Stock Purchase Plan under §423?

**Proposed Response.** No. The position in PLR 9531031 is inconsistent with the express wording of the regulation and is incorrect. The same result applies with respect to an Employee Stock Purchase Plan.

**IRS Response.** The IRS supports evergreen provisions in ISOs as long as the evergreen provision at the time of the shareholder approval vote expresses the maximum number of shares that may be granted and that the employee will get the lesser of the maximum or the number of outstanding shares. The same position would be taken for an employee stock purchase plan.

46. §3121(v) — FICA Taxation of Deferred Compensation

Employer maintains a phantom stock plan. Each participant is granted a fixed number of phantom units under the plan when they commence participation. Phantom units are equal in value to the fair market value of the employer's stock. When a participant terminates employment, he is entitled to receive a lump sum benefit equal to the difference between the then-current value of his phantom units and the value of those units on the date he commenced participation in the plan. Is the plan a nonqualified deferred compensation plan subject to the FICA tax timing rules of §3121(v), or is it a "stock value right" plan within the meaning of Treas. Reg. 31.3121(v)(2)-1(b)(4)(ii)?

**Proposed Response.** The plan results in deferral of compensation and is a nonqualified deferred compensation plan for purposes of §3121(v). The "stock value right" exception does not apply to a phantom stock plan, even if the benefit under the plan is computed solely on the basis of the amount of appreciation in a participant's phantom units.

**IRS Response.** The IRS disagrees with the proposed response, since the IRS would consider the described plan to be stock appreciation right instead of phantom stock. The stock value right exception would apply to the described plan.

47. §4975 — ESOPs

Can an ESOP preclude a participant from exercising his put option rights with respect to some, but not all, of the stock the participant receives from the ESOP?

**Proposed Response.** No. Neither §409 or the §4975 regulations authorize any such limitation upon the participant's ability to exercise his or her put option rights.
**IRS Response.** The IRS agrees with the proposed response, assuming the question is referring to statutorily required put options.

48. §4980B — Continuation Coverage

Assume that a dependent elects COBRA by reason of ceasing to qualify as a dependent. Can the former dependent elect to cover any children that she has after electing COBRA coverage?

**Proposed Response.** No. Section 4980B states that the term "qualified beneficiary" includes a "child who is born to the covered employee" during the period of continuation coverage. If this were intended to apply to children born to former dependents, the reference would be to a "child who is born to a qualified beneficiary."

**IRS Response.** The IRS agrees with the proposed response, but a qualified beneficiary has the right to elect family coverage, so the dependent who is a qualified beneficiary can elect family coverage in order to cover the child.

49. §4980B — Continuation Coverage

An employer of more than 50 employees maintains a group health plan, one feature of which is a prescription drug card with a $10.00 co-pay amount. The plan requires COBRA beneficiaries to pay the full price for their prescriptions and refunds the excess of the full price over the aggregate of the co-pays at the end of each month, in contrast to similarly situated non-COBRA beneficiaries who are never out-of-pocket for the difference between the co-pay and the full price of each drug purchased. Does this arrangement satisfy the plan’s obligation to COBRA beneficiaries to provide "the group health plan coverage that is provided to similarly situated non-COBRA beneficiaries?"

**Proposed Response.** No. The requirement to provide the "coverage" to COBRA beneficiaries that is provided to similarly situated non-COBRA beneficiaries includes the timing of the benefit of co-pay amounts. Since non-COBRA plan beneficiaries need only pay a $10.00 co-pay to receive prescription drugs upon payment of only the co-pay amount, this distinction in treatment between COBRA and non-COBRA beneficiaries renders the coverage under the plan different for COBRA beneficiaries from non-COBRA beneficiaries, thus "the coverage offered does not constitute COBRA continuation coverage and the group health plan is not in compliance with COBRA . . ." as described in Treas. Reg. 54.4980B-5 Q&A-1 (a) of the final COBRA regulations.

**IRS Response.** The IRS agrees with the proposed response.

50. §4980B — Continuation Coverage
A multiemployer plan offers two different types of coverage to contributing employers based on their negotiated contribution rates: "Plan A," which provides for in-network coverage only and "Plan B," which covers all treatment at 80 percent under a standard indemnity plan. No employer participates in more than one Plan. Employee M receives Plan A coverage through Employer M. Plan A is the only coverage offered to employees of Employee M. Employee M terminates employment and moves out of state. Plan A coverage can not be provided in the new state of residence because there are no network providers there. Does the multiemployer plan have to offer Employee M COBRA under Plan B, which would cover him in his new state of residence, because the multiemployer plan makes this coverage available to employees of other employers who have negotiated for this type of coverage?

**Proposed Response.** If a qualified beneficiary participates in a region-specific benefit package that will not service his or her health needs in the area to which she or he is relocating (regardless of the reason for the location), the qualified beneficiary must be given an opportunity to elect alternative coverage that the employer or employee organization makes available to active employees. If the employer or employee organization makes group health plan coverage available to similarly situated non-COBRA beneficiaries that can be extended in the area to which the qualified beneficiary is relocating, then that coverage is the alternative coverage that must be made available to the relocating qualified beneficiary. In the case at issue, the multiemployer plan does not have to offer Employee M, the qualified beneficiary, alternative coverage (Plan B), because the multiemployer plan does not make group health plan coverage available to similarly situated non-COBRA beneficiaries that can be extended to the employee at issue. The employees who are similarly situated -- i.e. the other employees of Employee M's employer -- only receive coverage under Plan A and that coverage can not be extended to his new area of residence. In the case of a multiemployer plan, the "employer" who is making the coverage "available" is the individual contributing employer and not the multiemployer plan that offers different types of coverage to employers.

**IRS Response.** The IRS disagrees with the proposed response. This might have been the right answer under the old regulations, but under the revisions to the regulations, this will not work.

51. §6058 — Annual Return

The Instructions to the Form 5500 indicate that, in the case of a multiple employer plan, each employer must file its own complete Form 5500 if an employer's contributions can only be used to provide benefits for its employees. Won't this condition always be satisfied in the case of a defined contribution plan? Must the Form 5500 prepared by each participating employer specify just the information that relates to the participants attributable to that employer?
Proposed Response. Yes. A separate Form 5500 must be prepared for each participating employer in all cases involving a defined contribution plan, and the Form 5500 must contain only the information relating to that employer's employees (it cannot simply provide information regarding the entire group of participants).

IRS Response. The IRS agrees with the proposed response. Each adopting employer must file a separate Form 5500 C/R for its workforce.

52. §7805(b) - IRS Determination Letters - Exclusion of Independent Contractors

It appears that at least one IRS district office reviewing a determination letter request for a plan that excluded persons classified as independent contractors has responded that this exclusion did not satisfy the eligibility requirements of the Code because the plan did not set out definite written standards for the classification of independent contractors. The plan contained language providing that in certain situations, such as if an individual was classified erroneously, the individual would be excluded from participating in the plan. The district office responded that this language could not be used to specifically and objectively exclude individuals from the plan.

Does the IRS have an official position on this issue? If provisions like those above are not permitted, is there a way to draft plan language to exclude independent contractors and employees misclassified as independent contractors that the IRS would approve? Is any IRS guidance planned on this issue?

Proposed Response. In view of the Microsoft litigation, employers need a way to draft plan language to exclude from coverage workers not intended to be covered by the plan. The IRS should permit employers to use plan language excluding from coverage workers initially categorized as independent contractors, regardless of whether they are subsequently determined to be common law employees.

IRS Response. The IRS noted a technical advice memorandum on this issue is pending. While unable to fully describe their position, the IRS noted they believe employers should be able to protect themselves from retroactive changes in employment status.

53. §7805(b) — IRS Determination Letters

ABC Corporation adopted an individually designed non-volume submitter defined contribution plan effective January 1, 1996. The plan was submitted to the Internal Revenue Service (with a $700 User Fee) and received a favorable determination letter in March of 1997. No amendments have been made to the Plan. It is now time to amend the Plan for GATT, USERRA, SBJPA and TRA ("GUST"), which can be accomplished with a three or four page amendment. The
Plan Sponsor desires to obtain a determination letter with respect to the GUST amendment. The Plan Sponsor understands that the complete Plan document must be included in the submission in order that the Service may see how the GUST amendment affects other provisions.

a. What is the User Fee for this submission?
b. If the practitioner who drafts the GUST amendment for ABC Corporation incorporates language from its Volume Submitter Specimen Plan (approved for GUST), may the GUST amendment be submitted under the Volume Submitter Program, even thought the original Plan document is not under Volume Submitter? The User Fee for this three to four page amendment would then be reduced.

**Proposed Response:**

c. Even though the GUST amendment may not be submitted using Form 6406, it would appear fair to charge a lesser User Fee, perhaps $125 as is normally charged for an amendment using Form 6406. The full $700 should be charged only when the plan has been restated in its entirety.
d. If the Volume Submitter submits the GUST amendment on behalf of the Plan Sponsor and used approved language from its specimen plan, the amendment should be submitted using Form 5307 and the reduced User Fee. However, if the GUST amendment is the second or third amendment to the plan, and the earlier amendments did not use pre-approved volume submitter language and have not been ruled upon, Form 5500 must be used with a higher User Fee.

**IRS Response:** The IRS disagrees with both proposed responses. This is not a volume submitter plan situation, so the normal user fees will apply.