Joint Committee on Employee Benefits Q&A
with the U.S. Treasury Dept. and Internal Revenue Service
based on meeting with staff
May 12, 2000

The following questions and answers are based on informal discussions between private sector representatives of the JCEB and Treasury Department and Internal Revenue Service officials. The questions were submitted by ABA members and the responses were given at a meeting of JCEB and government representatives. The responses reflect the unofficial, individual views of the government participants as of the time of the discussion, and do not necessarily represent agency policy. This report on the discussion was prepared by designated JCEB representatives, based on the notes and recollections of the JCEB representatives at the meeting, and has not been reviewed by Treasury or IRS personnel. The questions were submitted in advance to the agency, and it was understood that this report would be made available to the public.

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1. **§83 – Property Transferred in Connection with Performance of Services**

   Does the IRS continue to support the position in FSA 19940014 that an employee may not make a section 83(b) election regarding stock that is nonvested because the shares would be subject to the short-swing profits recovery rules of section 16 of the Securities Exchange Act of 1934? See Treas. Reg. §1.83-3(j). If so, would the same result apply if the share were deemed to be nonvested because of the rules of Treas. Reg. §1.83-3(k), relating to the pooling of interests method of accounting?

   Proposed Answer: This position taken in FSA 199940014 is erroneous. Also, employees may make section 83(b) elections with respect to shares subject to restrictions on resale because of the pooling of interests method of accounting.

   IRS Answer: The IRS disagrees with the proposed answer. The FSA is correct, but has been misread in the question. Employees may always make a section 83(b) election if nonvested property is transferred.

2. **§101 – Death Benefits**

   An employer maintains a VEBA that provides, among other benefits, a lump sum death benefit that is entirely self-funded by the employer; no commercial insurance is purchased. The benefit is funded on an actuarially sound basis, and the VEBA has ample funds to pay all death benefits. Counsel represents that the employer's authority to amend the death benefit program does not alter the plan's liability to pay a death benefit when the death occurs before termination or

amendment. Counsel also represents that the plan is subject to ERISA and that state insurance laws are preempted with respect to the VEBA.

Are the death benefits excludable from beneficiaries' gross income pursuant to section 101(a)?

Proposed Answer: Yes. The VEBA and death benefit programs are similar to those described in PLR 199921036. The fact that the VEBA described in the letter ruling was maintained pursuant to a bargaining agreement is not sufficient to distinguish it from the above situation.

IRS Answer: The IRS disagrees with the proposed answer. In the ruling, the taxpayer represented that the applicable law was ERISA and the IRS did not challenge that representation. What is applicable law for purposes of section 101(a) is receiving appropriate policy attention.

3. §105 – Accident and Health Plans

An employer maintains a medical program that is not part of a cafeteria plan and is not a flexible spending account. The program permits a participant to change medical coverage mid-year under certain limited circumstances that are not contemplated by Treas. Reg. §1.125-4. Does the failure to follow the election rules under section 125 prevent the medical program from meeting section 105(b)?

Proposed Answer: No. Proposed Treas. Reg. §1.125-1, Q&A 17 (1984) provides that the exclusion for medical benefits under section 105 requires a plan that exhibits the risk-shifting and risk-transfer characteristics of insurance. Treas. Reg. §1.125-4 does not refer to section 105 and by its terms is applicable only to cafeteria plans and flexible spending accounts. So long as the medical program can satisfy whatever risk transfer and distribution principles that may apply under section 105, the more generous election rules of the employer's medical program should not result in the loss of the income tax exclusion of section 105. Whether or not the program provides for risk transfer and distribution is a factual issue and a failure to satisfy the election rules of section 125 is not necessarily determinative.

IRS Answer: The IRS agrees with the proposed answer. The regulation covers a specific set of rules and plans, and doesn't apply to other plans.

4. §162(m) – Excessive Employee Remuneration

Can a "material modification" for purposes of section 162(m) be a reduction in benefits?

<u>Proposed Answer</u>: Yes, the term is not "material increase" in benefits. Any material alteration, whether positive, negative, or neutral, can be a material modification.

<u>IRS Answer</u>: The IRS disagrees with the proposed answer. Treas. Reg. 1.162-27(h)(1)(iii) provides that a material modification occurs when a contract is amended to increase the amount of compensation payable to an employee.

5. §401(a) – Domestic Trust Requirement

A foreign corporation establishes a plan that is intended to meet the requirements of section 401(a). The trust funding the plan is created pursuant to state law; the designated trustee is domiciled in the United States; and all plan assets are located in the United States. All documents and filings indicate that the foreign corporation treats the trust as domiciled in the United States. The foreign corporation has the power at any time to amend the plan and to replace the trustee, and reserves the authority to direct the investment of plan assets. Will IRS disqualify this plan solely because of the foreign corporation's control over the plan and trust?

<u>Proposed Answer</u>: No. Section 401(a) requires that the trust be created and organized in the United States, and this trust satisfies that qualification requirement. The fact that a foreign corporation has reserved full control over the trust does not cause the trust to fail to meet the qualification requirement. The definition of a United States person under section 7701(a)(30) is not relevant to the qualified status of a plan where the trust has clearly submitted to U.S. tax jurisdiction.

<u>IRS Answer</u>: The IRS is aware of the issue and working on a solution that will be preferable to the existing regulation. The IRS hopes to release something this year.

6. §401(a) – Plan Qualification Requirements Generally: Plan Sponsor

Assume that a corporation is undergoing a liquidation in a Chapter 7 bankruptcy, but that there are significant assets in the corporation's retirement plan. Could an individual assume sponsorship of the plan following liquidation of the employer (so that all of the benefits need not be paid out immediately)?

Proposed Answer: No. Plans may only be maintained by employers for the benefit of their employees. Where the individual never had a business, he could not assume sponsorship of the plan.

IRS Answer: The IRS agrees with the proposed answer. A qualified retirement plan must be maintained by an employer. If the employer is liquidated or no one is acting for that employer, the plan must be terminated and distributions would need to be made from the plan.

7. §401(a) – Plan Qualification Requirements Generally: Implications of One-Time Participant Choice Between Plans

What are the tax implications, if any, of allowing a one-time choice between alternative employee benefit design packages? For instance, an employer currently provides Package A to all active employees (traditional final average pay defined benefit pension, §401(k) plan with 25% match on first 4% of salary deferrals, 50% of post-retirement medical cost paid by employee). They intend to provide Package B to all new employees (cash balance pension, §401(k) plan with 100% match on first 6% of salary deferrals, 100% of post-retirement medical cost paid by employee).

If the employer offers all current employees the one-time choice between Package A and Package B, are there adverse consequences of offering that choice under either the assignment of income or constructive receipt doctrines (relating to the employer support of post-retirement medical cost), the defined benefit accrual rules, or the §401(k) contingent benefit rule. For purposes of the accrual rule, assume that the traditional final average pay formula and the cash balance formula are provided in the same defined benefit plan and that each formula would separately satisfy an accrual rule.

Proposed Answer: There are no current federal income tax consequences to employees who are offered the choice described in this example.

IRS Answer: The IRS agrees with the proposed answer, though it makes no comment on the different packages or issues related to the cash balance plan conversion. The offering of choice to participants, by itself, does not raise assignment of income issues or other tax consequences so long as they are offered before the person accrues the benefit.

8. §401(a)(4) – Nondiscriminatory Benefits

A cash balance plan provides for individualized benefit accruals based on the mutual fund combination chosen by the participant. A participant's "interest" accrual is based on the performance of the mutual funds he has chosen. How does one do a section 401(a)(4) general test for the plan?

Proposed Answer: None.

IRS Answer: In response to the specific question of how does one do a section 401(a)(4) general test for such a plan, the IRS responded "very carefully."

9. §401(a)(4) – Nondiscrimination and Testing Cycles

An employer sponsors two qualified plans, Plans A and B. Full nondiscrimination testing was performed in 1999. The two plans were not aggregated for coverage purposes, although each plan relied on a combined average benefit percentage test. There was a significant change in the provisions of Plan A in 2000, so new testing is therefore required for Plan A in 2000.

a. Can Plan B continue to use the results of the 1999 testing for 2000?
b. Can the Plan A testing for 2000 use an average benefit percentage test based on 2000 Plan A data and 1999 Plan B data as long as these results are not relied on beyond 2001?

Proposed Answer:

c. Yes. The fact that Plan A must test again in 2000 does not require that Plan B be tested again simply because the plans are considered together for purposes of the average benefits percentage test.
d. Yes. The fact that Plan A had a significant change in its provisions does not require the data collection necessary to do the average benefits percentage testing on Plan B for 2000.

IRS Answer: The IRS disagrees with both proposed answers. A significant change has occurred that affects the nondiscrimination and coverage test, and neither plan can rely on the prior average benefit test. Both plans have to be tested again in 2000.

10. §401(a)(9) – Minimum Distributions

Assume a participant began receiving distributions (prior to termination of employment) following attainment of age 70 ½. The participant subsequently

dies, while still employed and without electing a form in which his benefit is to be paid. May the surviving spouse continue to receive distributions at the same rate?

Proposed Answer: Yes. This is the same rate at which distributions were being made while the participant was alive, so that automatically satisfies section 401(a)(9).

IRS Answer: The IRS notes that the proposed answer assumes the current distribution complies with the required minimum distribution rules, even though the distributions are before the participant's required beginning date. If the participant is not a 5% owner, they have not reached their required beginning date. If the participant has elected a distribution form that would otherwise satisfy the minimum distribution rules, Q&A 10 in Notice 97-10 indicates that the plan can continue to pay the distribution in the same form.

11. §401(a)(17) – Compensation Limitation

Assuming that all qualified plans have calendar plan years, if an employee earned $81,000 in 1999, is he "highly compensated" for 2000?

Proposed Answer: No. According to the statute he needed to have compensation in excess of $85,000 in 1999 to be "highly compensated" for 2000. Treas. Reg. §1.414(q)-1T Q&A-3(c)(2), which may cause some people to reach a different conclusion, became obsolete with the passage of the 1996 Tax Act.

IRS Answer: The IRS disagrees with the proposed answer. Notice 97-45 supplements the regulations, which endorses the application of the indexed dollar limit to the lookback year of 2000. The determination of highly compensated employees in 2000 plan years should be based on pay in 1999, using the limit in effect for 1999. In response to a question from the floor, the IRS noted this answer is consistent with a general information letter issued December 10, 1999 that was reported in the trade press.

12. §401(a)(26) – Minimum Participation & Former Employees

The repeal of section 415(e) is regarded as a plan amendment for certain purposes (such as minimum funding). Treas. Reg. §1.401(a)(26)-4 generally requires that when a plan benefits former employees during a plan year at least 50 former employees or 40% of all former employees must benefit. (Certain alternative tests are also available.) However, Rev. Rul. 99-44 exempts these increases from nondiscrimination testing if the plan tested for nondiscrimination without regard

to §415 limits. Does this exemption extend to the §401(a)(26) minimum participation requirements?

Increases in benefits due to the indexation of the §415(b) limit for inflation are treated similarly for nondiscrimination purposes. Are these increases exempt from the minimum participation requirements as well?

Proposed Answer: Plans providing uniformly applicable benefit increases due to the section 415(e) repeal would not fail to satisfy Reg. 1.401(a)(26)-4 on account of these benefit increases provided that the plan satisfies section 401(a)(4) nondiscrimination either (a) as a safe harbor plan or (b) under the general test not taking section 415 limits into account.

Thus, the only situation where a former employee would be treated as benefiting on account of benefit increases due to the repeal of section 415(e) would be if the plan satisfies the section 401(a)(4) general test taking the 415 limits into account. In that case, unless at least 50 or 40% of former employees are affected by the repeal of section 415(e), the plan would fail to satisfy section 401(a)(26).

IRS Answer: The IRS agrees with the proposed answer. For defined benefit plans, benefit increases for former employees must benefit the lesser of 50 former employees or 40% of the former employee population. A plan that would fail to satisfy that general rule can use a special rule that benefit increases that result from §415 increases are not considered benefit increases for §401(a)(26) testing purposes as long as the plan is not testing for nondiscrimination taking the §415(e) limit into account. Additionally, the increase has to be uniform. The plan can't pick and choose which former employees' benefits to increase.

13. §401(k) – Cash or Deferred Arrangement

Can an individual receive a distribution from a section 401(k) plan following termination of employment, even though the individual continues to receive payments from the employer pursuant to a severance agreement? If not, can the individual make section 401(k) contributions with respect to the payments made pursuant to the severance agreement?

Proposed Answer: The individual can receive a distribution as long as there is a bona fide termination of employment. If there has been a termination of employment, though, no further elective contributions may be made by the individual pursuant to section 401(k).

IRS Answer: The IRS agrees with the proposed answer. An employee who is no longer rendering service can receive a distribution, notwithstanding that the

employer is continuing to pay the employee compensation, such as severance benefits.

14. §401(k) – Cash or Deferred Arrangement

Assume that a professional receives distributions from the partnership following the cessation of his performing services for the partnership ("Cessation"), in the form of professional fees that are attributable to services performed prior to Cessation, but collected following the Cessation. Can the individual make Section 401(k) contributions with respect to those payments? Does it make any difference whether the payments are received in the same calendar year as the Cessation?

Proposed Answer: No. No section 401(k) contributions can be made with respect to amounts received following Cessation.

IRS Answer: The IRS agrees with the proposed answer. Only employees can defer contribution into a §401(k) plan.

15. §401(k) – Cash or Deferred Arrangement

Will the IRS revise Item 5 of the Schedule Q to simplify the information that is needed with respect to a plan that only provides for Section 401(k) contributions and that all nonunion employees who have satisfied the applicable age and service requirements are eligible to participate in the plan?

Proposed Answer: Yes. The additional information required by that item provides no useful information, because a plan that allows all nonunion employees who have satisfied the age and service conditions to elect to make section 401(k) contributions automatically satisfies the coverage requirements.

IRS Answer: The IRS noted that the 2000 form is being revised, and welcomes such comments and will give it serious consideration.

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

If the acquirer makes a section 338 election, can a purchase of stock be treated as a purchase of assets for purposes of the section 401(k) distribution rules?

Proposed Answer: Section 338(a) provides that the transaction is treated as a purchase of assets for purposes of this Title, which includes section 401(k).

IRS Answer: The IRS disagrees with the proposed answer. The sale of a corporation must be a sale of a corporation, and the transaction has to fit within the terms of 401(k)(10) regardless of how the transaction is treated for other purposes of the Internal Revenue Code.

17. §402 – Taxability of Beneficiary of Employees' Trust

Is PLR 8538062 (June 25, 1985) still good law? Under this PLR, to the extent that the participant rolls over a portion of the distribution, the taxable portion of the distribution is reduced by the fair market value of the stock rolled over. Thus, the participant can retain shares equal to the NUA and rollover an amount of stock equal to the basis. There would be no tax on distribution, and the participant would get long-term capital gain treatment when the retained portion of the stock is sold.

Proposed Answer: No. That PLR was issued in error.

IRS Answer: The IRS agrees with the proposed answer. Net unrealized appreciation follows the stock. If the stock is rolled over to an IRA, the ability to use the net unrealized appreciation rules on the stock is lost. The net unrealized appreciation treatment follows the stock.

18. §411(d)(6) – Anti-cutback Rule

A sponsor adopts an amendment to a plan changing the time for determining the interest rate to be used to determine lump sum benefits. The amendment is effective on its adoption date and provides that the existing provision for determining the interest rate will continue to apply to persons taking lump sums in the 12-month period after adoption, and the new time is to be effective for distributions payable more than one year after the date the amendment is adopted. Will this amendment be treated as reducing accrued benefits in violation of section 411(d)(6)?

Proposed Answer: There is no violation of section 411(d)(6). Treas. Reg. §1.417(e)-1(d)(10)(ii) says that there is no violation of section 411(d)(6) merely on account of a change in the time for determining the applicable interest rate if a distribution that occurs in the one-year period starting on the effective date of the amendment is determined using the interest rate under the plan determined at either the date prescribed before the amendment or the date for determining the interest rate after the amendment, whichever results in the larger distribution.

This regulation should be regarded as a safe harbor. Under this amendment, the participants terminating in the first year after the amendment is adopted will be receiving exactly what the document prior to amendment specified. Therefore, there can be no cutback for those participants. And the participants receiving lump sum benefits more than one-year after the effective date are receiving a lump sum benefit that is permitted by the regulation.

IRS Answer: The IRS disagrees with the proposed answer. The IRS would view the plan amendment as effective a year from adoption when the times for determining interest rate changes. Section 411(d)(6) protection is triggered when the plan interest rate changes.

19. §411(d)(6) – Anti-cutback Rule and Protection of Social Security Supplements and Level Income Options

Under Treas. Reg. §1.411(d)-4, Q&A 1(d), a social security supplement (other than a qualified social security supplement as defined in Treas. Reg. §1.401(a)(4)-12) is not a section 411(d)(6) protected benefit and therefore can be eliminated by a plan amendment. Is this true even if payment of the supplement has already commenced?

Alternatively, a plan permits employees to elect a social security level income option that is actuarially equivalent to the straight life annuity normal form of benefit. Under this option, the benefit payable before age 62 is increased and the amount payable after age 62 is reduced such that the difference between the two benefits is equal to an estimate of the employee's social security benefit. Can the plan be amended to eliminate such an optional form with respect to benefits already accrued?

Proposed Answer: A plan amendment can eliminate a social security supplement, other than a qualified social security supplement, and may be applied both to employees still active and to employees whose supplements have already commenced.

An optional form like the Social Security level income option described above may not be eliminated by a plan amendment with respect to benefits already accrued.

IRS Answer: The IRS agrees with the proposed answer. Section 411(d)(6) protects accrued benefits, and social security benefits are not accrued benefits and can be eliminated. From a tax qualification point of view, a social security supplement could be eliminated for a participant who has retired and commenced distribution of benefits, though the employer might not want to consider that course of action for other reasons.

20. §411(d)(6) – Elective Transfers

May a defined benefit plan that terminates in a standard termination offer, as the only alternative for active participants who do not choose an annuity (immediate or deferred, depending on their ages), a transfer of the lump sum value of their accrued benefit (on GATT) to a defined contribution plan maintained by the employer? Is it permissible not to offer a lump sum at plan termination even if the plan offers them, or mandates them in the case of small benefits, upon termination of service?

<u>Proposed Answer</u>: Yes, as long as the plan does not already contain language offering a lump sum cashout at plan termination. Distribution at termination of service and distribution at plan termination to people who are continuing in service are separate benefit-payment events, for which the plan may offer different payout options. The fact that the plan specifies the options available in the one case (employment termination) does not require that the same options be made available in the other (plan termination), and new or different distribution options in connection with plan termination can be added to an otherwise silent plan in the course of the termination.

<u>IRS Answer</u>: The IRS agrees with the proposed answer. The plan doesn't have to offer a distribution option at plan termination if the option is available upon separation from service, but the plan does have to offer the distribution option as part of termination distribution option, such as through an annuity contract. Under the proposed regulations, the benefit couldn't be transferred to a defined contribution plan under the elective transfer rules, but could be rolled over.

21. §414(l) - Merger of Unfunded and Overfunded Plans

Plan X and Plan Y are calendar year plans maintained by the same employer with a calendar tax year. The two plans merge on 12/31/1999. Neither plan requires quarterly contributions for 1999. Plan X has a minimum funding requirement and maximum deductible amount as of 12/31/1999 of $100,000. Plan Y is significantly over-funded (with a surplus significantly in excess of $100,000), and also has a credit balance in excess of $100,000.

a. If no cash contributions are made to Plan X for 1999, can the plan sponsor avoid paying a 10% excise tax on a 12/31/1999 funding deficiency?
b. What is the maximum deductible contribution with respect to Plans X and Y for the employer's 1999 tax year? In order to claim a deduction for such contribution, by what date must the plan sponsor make the contribution?

Proposed Answer:

c. If no cash contributions are made to Plan X for 1999, the plan must report a $100,000 funding deficiency, and the $10,000 excise tax must be paid with Form 5330.
d. The maximum deductible contribution is $100,000 with respect to Plan X and zero with respect to Plan Y. The contribution must be made before the date the employer's return for the applicable tax year is due, and is made into the merged plan.

IRS Answer:: The IRS agrees with the proposed answer. The funding deficiency doesn't disappear when the plans are merged.

22. §415 – Limits for Plans of Tax-exempt Entity

Section 415(b)(2)(F) says that the section 415 limit should be reduced from age 62 rather than the Social Security Retirement Age for "a plan maintained by an organization exempt from tax under this subtitle...." How should these provisions be applied to a plan sponsored by a controlled group that includes tax-exempt and for-profit entities, if the plan covers employees from both types of entities? If separate plans are maintained, so that one plan covers only employees of a tax-exempt entity?

Proposed Answer: The exception would not be available if the plan covers employees of both for-profit and tax-exempt entities. But, if the entities adopt separate plans, the plan of the tax-exempt entity may use the exception.

IRS Answer: The IRS agrees with the proposed answer. The exception does not apply for a plan covering both groups.

23. §415 – Effect of Automatic Cost of Living Adjustment

Plan A has an automatic cost of living provision that adjusts retiree benefits for inflation each year. Is the maximum benefit payable from the plan under section 415 reduced to reflect the expected value of the COLA? What if the plan provides an increase in benefit in accordance with section §415(d)?

Proposed Answer: If a plan has an automatic COLA feature, this is a form of accrued benefit that requires adjustment under IRC §415. If the plan does not have an automatic COLA feature, but allows for increases in benefits in accordance with section 415(d) so that benefits calculated in accordance with the plan formula that initially exceed section 415 limits are allowed to increase to

their originally calculated level, then there is no adjustment under section 415 for this feature.

IRS Answer: The IRS agrees with the proposed answer.

24. §415 – Limitations on Benefits

Will the IRS issue a revenue procedure setting for the conditions that need to be satisfied so that "restoration payments" (*e.g.*, PLRs 9830022, 9824041, 9807028, 199913047) are deductible and are not treated as a contribution to the plan for section 415 purposes, *etc.*

Proposed Answer: Yes, the promulgation of such a Revenue Procedure would help conserve the precious manpower resources of the IRS on relatively routine matters.

IRS Answer: The IRS appreciates the comment and will take it into account in developing future guidance priorities.

25. §422 – Incentive Stock Options

Can an ISO be issued to an employee of a brother-sister corporation?

Proposed Answer: No. While ISOs can be issued to employees of parent and subsidiary corporations, they cannot be issued to employees of brother-sister corporations. I.R.C. §§ 422(a)(2) and 424(e) and (f).

IRS Answer: The IRS agrees with the proposed answer.

26. §422 – Incentive Stock Options

Company A sponsors an incentive stock option plan. Company B acquires Company A, with the result that (i) Company A becomes a subsidiary of Company B, (ii) the incentive stock option plan continues to be maintained at the Company A level, but (iii) the stock options are converted into rights to purchase Company B stock. If any amendments to the incentive stock option plan are required, should the shareholder approval be of Company A or Company B?

Proposed Answer: Company B. Company A may only have one shareholder, the parent corporation.

IRS Answer: The IRS agrees with the proposed answer.

27. §423 – Employee Stock Purchase Plan

Can an employee stock purchase plan described in Section 423 issue shares to a living trust established by the participant without that being treated as a disposition?

Proposed Answer: Yes. Because the living trust is treated as a nullity for tax purposes, it is disregarded for this purpose.

IRS Answer: The IRS agrees with the proposed answer, as long as the trust is a revocable trust.

28. §501(c)(9) – Voluntary Employee Beneficiary Association

If an employer purchases stop loss coverage for a self-funded health plan with VEBA assets (instead of from employer's general assets), is there an anti-inurement or prohibited transaction problem?

Proposed Answer: The answer depends on whether the coverage is for the benefit of the employer or the plan.

IRS Answer: The IRS believes the answer depends who gets the proceeds of the policy if claims exceed the limit. If the policy proceeds go to the VEBA, there's no problem with the anti-inurement or prohibited transaction rules. If the proceeds go to the employer, something is wrong.

29. §3121(v) – FICA Tax Treatment of Nonqualified Cash Balance Plans

An employer puts in a new nonqualified cash balance plan. The benefit formula under the plan is very basic (e.g., annual credits equal to 1% of pay, increased annually with interest, with all optional forms actuarially equivalent). Thus, for FICA tax purposes, the nonqualified plan – absent other features – would be treated as an account plan with annual taxation of benefit accruals. However, for some plan participants, the plan does offset the plan benefits by the value of benefits from another plan where the benefit amounts are not frozen.

For FICA tax purposes, since the plan includes non-account plan features, could the benefits for all participants be taxed under the non-account plan rules? And if

so, would participants who do not have a benefit offset, have a resolution date every year?

Proposed Answer: For FICA tax purposes, this plan would be treated as an account balance plan, for those participants who are not subject to the offset provision, and as a non-account balance plan for those participants subject to the offset provision.

IRS Answer: The IRS agrees with the proposed answer. For nonqualified plans, there often is no asset pool, so the definition of what constitutes a "plan" is vague enough that the employer could treat the arrangement as two separate plans. If the arrangement is treated as a single non-account balance plan, the employer could bifurcate the plan into separate arrangements. The portion of the benefit that is not subject to the offset provision cannot be deferred from FICA wages past the resolution date, regardless of whether that portion of the plan is treated as an account balance plan or a non-account balance plan.

30. §3405 – Pension Withholding Requirements

A U. S. corporation has a number of employees who are nonresident aliens from Mexico. Must the employer withhold the mandatory 20% on "eligible rollover distributions" made to these employees?

Proposed Answer: No, because those amounts are not subject to tax-free rollover into an IRA or another tax-qualified retirement plan. However, those payments are subject to the standard withholding rules for amounts paid to nonresident aliens.

IRS Answer: The IRS disagrees with the proposed answer. The distribution can be rolled over to a U.S. IRA. If the distribution is not rolled over, for 2000 the distribution is still subject to the 20% mandatory withholding. The IRS noted that for 2001, there is an exception for distributions to nonresident aliens to use wage withholding. The IRS also noted there could be a treaty provision that affects the withholding on distributions to nonresident aliens.

31. §4980B – Continuation Coverage

Because, by its very nature, a health care expense flexible spending account ("FSA") covers the expenses of any dependent of an employee, aren't the employee's spouse and all dependents automatically eligible to elect COBRA with respect to the FSA, even if they were not covered by the employer's (insured) health care plan?

Proposed Answer: Yes. Any individual that was a spouse or dependent at the time of the COBRA qualifying event can elect it. However, this option is not available to individuals who become dependents after the date of the qualifying event, such as later-acquired dependents, despite such rights granted to them under Health Insurance Portability and Accountability Act of 1996.

IRS Answer: The IRS agrees with part of the proposed answer. A spouse or dependent child at the time of the qualifying event can elect COBRA coverage under a health FSA. However, a person who becomes a dependent later cannot elect continuation coverage under the health FSA. While many such dependents may not be eligible to elect COBRA independently from other qualified beneficiaries at the time of the qualifying event, a child born to or placed for adoption with a covered employee during a period of COBRA coverage is a qualified beneficiary and has rights to maintain continuation coverage under health FSA even if the covered employee later drops continuation coverage.

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