Joint Committee on Employee Benefits Q&A
with the Internal Revenue Service and
U.S. Department of Treasury
based on a meeting with staff on
May 12, 2001

The following questions and answers are based on informal discussions between private sector representatives of the JCEB and Treasury Department and IRS 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 discussions 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 IRS or Treasury. The questions were submitted in advance to the agencies, and it was understood that this report would be made available to the public.

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1. **§125 – Cafeteria Plans**

   May a cafeteria plan have one plan year (e.g., a calendar year) used for Form 5500 filing purposes and a different twelve-month period of coverage (such as one which corresponds to the policy year under an insurance contract the premiums for which are paid through the cafeteria plan) used for all other purposes, including when annual election changes may be made?

   Proposed Response: This is permissible because the regulations refer to changes in elections "during a period of coverage," and there is no requirement under the regulations that the "period of coverage" be the plan year.

   IRS Response: The IRS agrees with the proposed response, but noted practitioners should be careful about what it means to have a plan year, especially for purposes of Title I. What is a plan year is a facts and circumstances question. It isn't clear from this limited fact pattern what the plan year is. But there's no reason the plan year has to be the same as the cafeteria or coverage year.

2. **§401(a)(2) – Exclusive Benefit Rule**

   Can contributions serially made to a defined contribution plan through the Plan Year revert to the employer if the employee on whose behalf the contribution is tentatively made ceases to be employed before he accrues a right to have a contribution made on his behalf?

   For example, assume that Plan B is a §401(k) plan to which the employer contributes 3% of compensation. The plan has a last day rule. For budgetary reasons, the employer contributes 3% monthly to the accounts of participants. A non-key employee leaves before the last day of the year. The company would like to recover the amount contributed to her account for the year since she is not employed on the last day. However, §401(a)(2) prohibits the return of funds to the employer. Reversion is permitted in certain cases not specifically applying here.

Proposed Response: Rev Rul. 77-200 will be expanded to treat this as a contribution under a mistake of fact and permit the reversion.

IRS Response: The IRS disagrees with the proposed response. Rev. Rul. 77-200 was replaced by Rev. Rul. 91-4, but that ruling has the same kind of rule regarding what constitutes a mistake of fact. The IRS doesn't view missed estimates as a mistake of fact allowing reversion of excess contributions.

3. **§401(a) – Definite Allocation Requirement**

Would a profit sharing plan be qualified if it were drafted to provide that, each year, the employer's contribution will be declared by written instrument which provides a distinct contribution (dollar amount or percentage of pay) to be allocated to each participant separately? For example, if a plan had 42 participants, the employer's declaration would have to establish 42 separate contribution amounts (or rates), with each one expressly declared to be allocable to a particular participant. For purposes of this question, please assume that:

The plan has routine eligibility requirements (*e.g.*, one year of service and age 21), and that even if the plan had excluded classifications and/or conditions for eligibility to accrue a contribution (*e.g.*, a last day of year employment requirement) that the plan would satisfy coverage requirements under §410(b);

The plan would provide that forfeitures will be allocated in proportion to the individual allocations for that year, and;

The allocations would be subject to the condition precedent that they must satisfy the coverage and non-discrimination requirements.

Given that the IRS has relaxed its position on definite determinability in the declaration of contributions/allocations it seems both reasonable and feasible to operate a plan on this basis. Little could be clearer than to expressly state the amount to be allocated to each participant individually. For example, there would be no question as to whether a participant is in one division or another, because each individual is separately identified, regardless of his or her job classification changes throughout the year.

Unlike the average benefit percentage test for coverage, the non-discrimination regulations do not contain a "reasonable classification" requirement that would prohibit the identification of individual participants, by name, as separate contribution groups.

Proposed Response: It seems conceivable that, if the employer could declare a 0% contribution for any participant, the plan could run afoul of the minimum coverage requirements, because a 0% allocation could have the effect of excluding individuals by name. Therefore, in the case of a plan that would make 0% allocations (and which is not permissibly aggregated with another plan that provides some level of benefit for the participant receiving nothing under the profit sharing plan) the plan would have to satisfy the ratio percentage test in order to satisfy minimum coverage. However, nothing else would seem to limit this approach to plan design.

IRS Response: The IRS agrees with the proposed response.

4. **§401(a) – Definitely Determinable Benefits**

In order to be qualified, must a plan specify some (or all) testing methodologies? For example, if, for a particular year, a plan must be permissibly aggregated, cross-tested, and employ permitted disparity, must the plan document (or any other written instrument) expressly state the methodologies that are being employed? In the event methodologies must be documented, when must the documentation be adopted in order to be effective for any particular plan year?

Proposed Response: Certain testing methodologies must be in writing prior to the beginning of a plan year in which the methodology will be employed, because the law mandates prior documentation. This applies to the SBJPA provisions impacting §401(k) plans, including §401(k) safe harbor elections, current or prior year testing elections and top-paid group elections. However, no other testing methodologies need be incorporated into the plan document or reduced to writing at any time, as long as the plan is able to demonstrate that the allocation satisfies the qualification requirements under some set of testing methodologies.

IRS Response: The IRS view is that testing methodologies and provisions must be specified in the plan document if they can affect benefit or contribution levels. ADP testing must be specified in a §401(k) plan, including correction methodologies, since they can have a significant affect on deferral and other contribution levels.

5. **§401(a) – Pension Plan Distribution Restrictions**

Can a pension plan distribute benefits to an active employee who has ceased plan participation as part of a partial plan termination?

Treas. Reg. §1.401-1(b)(1)(i), defines a pension plan for purposes of §401(a) in terms contemplating that distributions generally will be made upon or after retirement. IRS guidance has recognized that distributions can be made to active employees prior to normal retirement age upon plan termination. See, for example, Rev. Rul. 56-693. It is unclear whether a partial termination is a plan termination for purposes of allowing distributions to affected active employees.

Rev. Rul. 74-254 indicates that an employee who ceases plan participation but continues employment cannot receive a distribution from a pension plan, but that ruling discusses situations where participation ceases on account of a job transfer or reclassification, or failure to satisfy minimum work requirements. It allows distributions upon plan termination, but doesn't clarify what types of terminations permit pension distributions.

Proposed Response: A partial termination is a plan termination for purposes of §411, which is a qualification requirement under the Code. Accordingly, a partial termination is a plan termination for other qualification requirements, including the distribution restrictions on pension plans. An active employee who ceases plan participation as part of a partial termination can receive a distribution from a pension plan as long as the other qualification requirements associated with plan distributions (*e.g.*, participant and spousal consent) are satisfied.

IRS Response: The IRS disagrees with the proposed response. A partial termination is an event that triggers full vesting, but it is not a plan termination for purposes of §411. Some other distributable event is necessary to allow distribution of benefits.

6. **§401(a)(4) – Design-Based Safe Harbor Plans**

Can a plan be a designed-based safe harbor if it requires last day of year employment and/or more than 500 hours of service as condition(s) for allocation *and* does not contain definitely determinable language for suspending those requirements in the event the allocation fails the ratio percentage test for coverage?

Proposed Response: No. Without self-correction language the plan could, in routine course, fail the ratio test for coverage. Without definitely determinable provisions, the plan isn't qualified.

IRS Response: A fail-safe mechanism is not required and not encouraged by the IRS. While fail-safe provisions are not prohibited, the IRS generally believes it is very difficult to write such a provision that satisfies the definitely determinable benefit rule.

7. **§401(a)(4) – Design-Based Safe Harbor Plans**

Can a plan be a design-based safe harbor for non-discrimination purposes if it provides that a participant who is credited with less than 1000 hours of service will get only a top-heavy minimum (if needed), and the plan allows a higher rate of allocation for those with over 1000 hours?

Proposed Response: No. Treas. Reg. §1.401(a)(4)-2(b)(4)(iv)(D) provides that a plan must provide the full measure of benefit to all participants in order to consider them as "benefitting" under a safe harbor design. As a result, if the plan document fails to require a higher benefit for such participants the plan would not satisfy the exception to the safe harbor requirements. Accordingly, in order to be a designed based safe harbor, additional self-corrective language is required.

IRS Response: Treas. Reg. 1.401(a)(4)-2(b)(4)(iv)(D)(3) indicates that disuniformity in benefits attributable to top heavy formula benefits is accepted in the context of the safe harbors only if the people getting the top heavy benefit aren't necessary to satisfy the coverage tests.

8. **§401(a)(9) – Required Minimum Distributions**

Is the method for calculating the actuarial increase under §401(a)(9)(C)(iii) the same as the method for calculating the actuarial adjustment under §411(a)(3)(B)?

Proposed Response: No. Although Prop. Treas. Reg. §1.401(a)(9)-6, Q&A 9 indicates that the actuarial increase required under 401(a)(9) "is generally the same as, and not in addition to, the actuarial increase required for the same period under section 411 to reflect any delay in the payment of retirement benefits after normal retirement age," the method for calculating the actuarial increase is quite different.

Prop. Treas. Reg. 1.411(b)-2(b)(4)(iii)(B) indicates that the actuarial adjustment is made "to the greater of the participant's retirement benefit as of the close of the prior plan year, including any actuarial adjustment made under the plan for the prior plan year, and the participant's normal retirement benefit as of the close of the prior play [sic] year determined by including benefit accruals…." In essence, each year the participant's benefit is increased by the greater of the actuarial adjustment to the benefit payable the prior year or that year's benefit accrual.

Prop. Treas. Reg. §1.401(a)(9)-6, Q&A 8 indicates that the actuarial adjustment "must be no less than: the actuarial equivalent of the employee's retirement benefits that would have been payable as of the date the actuarial increase must commence under A-7(a) of this section if benefits had commenced on that date; plus the actuarial equivalent of any additional benefit accrued after that date…." In essence, each year the participant's benefit is increased by the sum of the actuarial adjustment to the benefit payable the prior year and that year's benefit accrual.

IRS Response: The IRS disagrees with the proposed response. Prop. Treas. Reg. §1.401(a)(9)-6, Q&A 9 indicates that the actuarial increase required under

§401(a)(9) is generally the same and not in addition to, the actuarial increase required for the same period under section 411 to reflect any delay in the payment of retirement benefits after normal retirement age. The regulation also indicates that the actuarial adjustment under §401(a)(9) must also be provided for a period during which the participant's benefit has been suspended under ERISA §203(a)(3)(B).

The proposed response fails to point out that the proposed 411(b) regulations provide both a general rule that requires an annual adjustment and a rule that only applies if the plan suspends benefits in accordance with ERISA §203(a)(3)(B). The actuarial adjustment must be provided under §401(a)(9) regardless of whether benefits are suspended. The proposed §401(a)(9) should be read in conjunction with Notice 97-75.

9. **§401(b) – Remedial Amendment Period and Determination Letters**

When filing for a determination letter for a Plan that uses an Adoption Agreement that applies to a Plan approved on a Volume Submitter basis, must the submission include a copy of the Volume Submitter document as well as the Adoption Agreement?

Assume a Volume Submitter plan that is the successor to a regional prototype is approved by the IRS. Since the plan is based on a regional prototype, the plan uses an Adoption Agreement.

The Cincinnati office has informally indicated that when the employer files for a determination letter after adopting an approved Volume Submitter plan, it will be necessary to file the plan along with the adoption agreement. This is because the rules have been written with the traditional Volume Submitter in mind - that is, as a plan that does not use an adoption agreement.

The plan, like the old regional prototype, never changes in text from employer to employer. The adoption agreement gives choices. If an employer wants to deviate from the plan, it would be necessary to make a supplement to the adoption agreement.

Proposed Response: So long as someone named on the Power of Attorney states that the Volume Submitter Plan has received a favorable notification letter, inclusion of a copy of the Volume Submitter document in the submission package will not be required.

IRS Response: The IRS disagrees with the proposed response and needs to see the Volume Submitter document as well as the Adoption Agreement. There are often blank sections in a Volume Submitter plan document, so the IRS needs to see how those sections are filled out.

10. **§401(b) – Remedial Amendment Period and Determination Letters**

Is the date by which a plan conforming to a Volume Submitter Plan for which the notification letter was issued sometime in 2000 have until the end of the plan year that begins in 2001 to adopt the restated plan?

Assume a Volume Submitter Plan has received a favorable notification letter in March, 2000. There have been different responses from IRS agents concerning when the employer subscribing to the plan must adopt the adoption agreement. The reaction of at least one IRS agent was that the employer subscribing to this Plan must do so within one year from the date of the letter, *i.e*., by the end of March 2001. On examination, another IRS agent has indicated that the date of compliance is the end of the Plan Year beginning in 2001 or one year from the date of the issuance of the notification letter, whichever is later. The latter answer appears to be correct.

Proposed Response: Yes, the employer must adopt the adoption agreement by the end of the Plan Year beginning in 2001 or one year from the date of the issuance of the letter, whichever is later.

IRS Response: The IRS agrees with the proposed response.

11. **§401(b) – Remedial Amendment Period and Determination Letters**

An individually designed calendar year plan is timely submitted for a GUST determination letter by December 31, 2001. On April 1, 2002, while its request for determination is pending with the IRS, the plan sponsor decides to convert its plan to a prototype plan. However, assume that Plan Sponsor of such prototype plan, although it filed a GUST - compliant document with the National Office of the IRS in a timely manner in 2000, has not at that time received its favorable opinion letter, *e.g.*, in April 2002, the Prototype Plan Sponsor does not have an approved plan that has been amended for GUST. Therefore, if the plan sponsor of the individually designed plan were to adopt the only plan of the prototype plan sponsor that has received a favorable IRS opinion, *i.e.*, the pre-GUST opinion letter, it would be amending from a plan that will ultimately be tax-qualified to a plan that is not on the date of adoption tax-qualified, although that disqualifying defect can presumably be cured within the remedial amendment period under §401(b) when the Prototype Plan Sponsor receives its favorable opinion letter in 2002. If, however, the sponsor of the plan that is converting to a prototype plan had executed a certification with a prototype plan sponsor by December 31, 2001 it would have been protected from this contingency, because it would then have 12 months from the date the prototype plan sponsor received its favorable opinion letter to re-execute an Adoption Agreement. Rev. Proc. 2000-20, Section 19.

Alternatively, assume the same facts as above, except that the individually designed plan has received a favorable determination letter from the District Office before attempting to convert to a prototype plan.

Proposed Response: Although neither of these situations is addressed in Rev. Proc. 2000-20, Section 19, there is no principled basis for distinguishing these two situations from that of the employer who enters into a written certification with the prototype plan sponsor. Therefore, the employer described in the two fact patterns described above should also be entitled to a twelve month period after the prototype plan sponsor receives its favorable opinion letter from the National Office. While nothing would preclude the sponsor of an individually designed plan from availing itself of the relief provided under Rev. Proc. 2000-20, Section 19, there may have been no reason whatsoever for the sponsor of the individually designed plan to even consider such action, if the decision to convert to a prototype plan is made in 2002.

IRS Response: The IRS disagrees with the proposed response. An individually designed plan doesn't get a later date by "hopping on" a prototype plan document. The plan choice has to be made at the end of the 2001 plan year.

12. **§401(b) – Remedial Amendment Period and Determination Letters**

Will an affidavit from someone on the Power of Attorney that a plan meets conditions of an earlier determination letter negate the necessity of a later agent's examining the file to validate that this is so?

In the past, some benefit practitioners were able to submit plans on an unsigned basis. As changes were made in the course of processing the plan for a determination letter, the practitioner simply revised the proposed plan. The determination letter referred to these changes as "proposed amendments." Transmittal by the IRS in Cincinnati of the GUST amended plan to offices outside the Cincinnati area caused the next IRS agent in the new district to examine the prior IRS determination letter. The agents have consistently demanded to see the "amendments" referred to in the prior determination letter because they have no access to the old file in Cincinnati. The explanation that the changes demanded had been incorporated into the document at execution had to be substantiated by retrieving the entire correspondence between the practitioner and the last reviewing agent to satisfy the new reviewer. This has slowed down the reviewing process and added to the expense of procuring the new determination letter. It probably has added to the bulk of the files of the IRS.

An affidavit can be given that the changes referred to in the last determination letter as amendments were in fact made. If need be, caveats could be placed on the determination letter that the pre-GUST plan is subject to examination to establish that prior requirements were met. The Plan is of course subject to examination on audit to determine if the statement in the affidavit is true.

Proposed Response: Such an affidavit will be acceptable but does not preclude the Service from auditing the Plan and demanding proof later that the condition was timely met.

IRS Response: The IRS agrees with the proposed response. When reviewing a determination file that has a prior favorable determination letter that includes caveats indicating that there were proposed amendments rule upon, it has been IRS policy not to require copies of executed versions of amendments. The IRS believes this is an issue that can be dealt with on plan examination. Unless there is evidence that the adopting employer did not timely adopt the proposed amendments, the IRS does not believe the agent working the determination letter needs to secure the executed amendment.

13. **§401(b) – Remedial Amendment Period and Determination Letters**

How should a qualified retirement plan be amended for GUST and how does it get a determination letter, if at all, if the plan no longer exists as a result of the transfer of its assets and liabilities to another plan?

For example, assume Company A and Company B (unrelated) each have qualified §401(k) plans, covering all of their employees, that have been around since the early 1980s. Each plan has a current pre-GUST determination letter and is a calendar year plan. Neither has been amended for GUST, in any respect, but both have been operated consistently with GUST. Both plan sponsors intend to retroactively amend for GUST. Effective July 1, 1999, Company A acquires all of the stock in Company B. Effective January 1, 2000, all of the assets and liabilities of the Company B §401(k) plan are transferred to the Company A §401(k) plan. A final annual report is filed for the Company B plan for the year ended 12/31/99. Company A is getting ready to prepare the GUST amendments and restatement for the Company A §401(k) Plan, and wonders what it and Company B (now its wholly-owned subsidiary) should do regarding the Company B plan. Must it prepare amendments for the Company B plan as it existed before Jan. 1, 2000?

May it, or must it, include amendments to the Company B plan within the GUST amendment and restatement of the Company A plan? Let's assume that the ADP/ACP testing for the Company A plan was done as follows: 1997 – prior year; 1998 - prior year; 1999 - prior year; 2000 - current year. ADP/ACP testing was done for the Company B plan as follows: 1997 - current year; 1998 - current year; 1999 - prior year. Let's also assume that the Company B plan began cashing out at the $5,000 level beginning January 1, 1998, while the Company A plan continued at the $3,500 level until January 1, 2000, when it changed to $5,000. How does Company B obtain a pre-Jan. 1, 2000, GUST determination letter, or the equivalent assurance, for the Company B §401(k) plan? May it obtain a separate letter, or may Company A receive a letter that also covers the Company B plan?

Proposed Response: None.

IRS Response: Regardless of how the plan is filed, the sponsor will need all the relevant amendments back to the last determination letters for the respective plans. The survivor plan can be submitted with the documents for the merged plan, with the documents reflecting the changes to both plans. Alternatively, determination letter requests could be filed for each plan. The IRS most commonly sees a single request in this situation.

14. **§401(b) – Remedial Amendment Period and Determination Letters**

Will the IRS issue a determination letter for a terminating plan when complete information called for by the Form 5310 is not available? Several of the Form 5310 items require plan and employee data going back several years. Plan terminations often involve corporate bankruptcies, acquisitions, and other situations where the information back that far is just not available, even though the plan has been around that long. Practitioners have experienced IRS agents who will accept less than complete Form 5310 applications in some cases, but not others, where the facts are not readily distinguishable.

Proposed Response: None.

IRS Response: The IRS generally only requests the facts that it needs, and is aware of the difficulty and expense of obtaining data on a variety of issues. The IRS does not try to "nitpick" the sponsor.

15. **§401(b) – Remedial Amendment Period and Determination Letters**

Describe the appropriate contents of a joint certification by a plan sponsor with a M&P sponsor that the plan sponsor intends to amend its plan for GUST through adoption of the M&P sponsor's M&P plan, as called for under Section 2(ii) of Announcement 2001-12.

Proposed Response: A certification is a declaration of intent, and consistent with the ability of a plan sponsor to decide not to use the M&P plan altogether, is not considered binding in any way. Consistent with an affirmative answer to the preceding question, the certification need not require the plan sponsor to preclude an intent to make amendments to the M&P plan immediately upon adoption which would cause the plan to be considered individually designed for determination letter review purposes.

IRS Response: The IRS agrees with the proposed response. The certification is a declaration of intent, but not evidence of completion of the task. The IRS noted that Rev. Proc. 89-13, §15.03, Appendix, item 4 had sample certification language.

16. **§401(k) – Cash or Deferred Arrangements**

IRS Notice 98-1 provides that a plan may change from the current year testing method to the prior year testing if "the change occurs during the plan's remedial amendment period for the SBJPA changes." IRS Notice 98-1, VII.A.4.

For a calendar year plan, the SBJPA remedial amendment period ends December 31, 2001. Can a calendar year plan that uses the current year testing method for 2001 change to the prior year testing method for 2002 if the plan amendment making the change is adopted before December 31, 2001?

Proposed Response: Yes. So long as the plan amendment is adopted within the remedial amendment period, the change to the prior year testing method can be made effective for 2002.

IRS Response: The IRS disagrees with the proposed response. The amendment must be both adopted and effective during the GUST remedial amendment period.

17. **§401(k) – Cash or Deferred Arrangements**

Is a SIMPLE-IRA considered a successor plan within the meaning of Treas. Reg. §1.401(k)-1(d)(3)?

Proposed Response: Treas. Reg. §1.401(k)-1(d)(3) excludes SEPs from the definition of defined contribution plan, so that the establishment of a SEP within the 24 month period beginning 12 months before termination of a §401(k) plan does not preclude distributions from the §401(k) plan. A SIMPLE-IRA should be treated the same as a SEP for this purpose because it also is merely a collection of IRAs and is not a qualified plan under §401(a).

IRS Response: The IRS agrees with the proposed response. It is reasonable to assume the reference to SEPs also includes SIMPLE plans for this purpose.

18. **§401(k) – Separation from Service**

Revenue Ruling 2000-27 discusses whether a "separation from service", within the meaning of §401(k)(2)(B)(i)(I), has occurred for employees of seller who are transferred to an unrelated buyer as part of a sale of assets constituting less than substantially all of the assets of a trade or business of the employee's employer. The ruling provides guidance and states that "in the circumstances considered here, the Transferred Employees are not employed in a continuation of the same trade or business." The ruling also provides that the transferred employees will continue to perform, without interruption and in the same capacity, the same functions for buyer that they performed for seller.

Private Letter Ruling 200101037, which discusses the sale of assets of certain retail stores, also concludes that the transferred employees continue to perform without interruption and in the same capacity, the same functions for buyer that they performed with seller. The PLR also concludes that "in the circumstances considered here, we have determined that the transferred employees are not employed in a continuation of the same trade or business."

There is some confusion regarding what the IRS means when it states that "transferred employees are not employed in a continuation of the same trade or business" because most asset purchases consist of companies purchasing assets from similar companies. For example, a bank may purchase assets from another bank.

Tax Management Portfolios, 385-3rd, has interpreted these rulings as requiring the buyer to be "in a different trade or business than the terminating employer."

What are circumstances that would result in a conclusion that the transferred employees are employed in a continuation of the same trade or business?

Proposed Response: The buyer is continuing the same trade or business of the seller only if it is required to be aggregated with seller after the sale (*i.e.*, part of the controlled group) under §§414(b), (c), (m) or (o).

IRS Response: A trade or business can be defined as a business unit. The definition of controlled group of trade or business is not controlling for this purpose. The fact that the employer has another business unit in the same type of business is not key.

19. **§402(c) - Rollover Of Loan Offset**

If a loan offset is the entire balance (or even part of the balance) and the participant wants to roll the offset amount (using other funds) to an IRA within 60 days of the offset, what documentation will the participant have to provide to his IRA custodian? There will be no check, and by the time 1099's are issued, the 60 days will have expired.

Proposed Response: The plan administrator of the distributing plan gives a statement to the participant similar to that described in Treas. Reg. §1.401(a)(31)-1, Q&A-14, Example 3. The statement would indicate the amount of the offset and would represent that the distributing plan is a qualified plan. The statement might also inform the participant that he may use other funds to roll the offset amount to an IRA or other qualified plan within 60 days to avoid taxes and penalties. The statement would be in a form that would satisfy the receiving IRA or qualified plan.

IRS Response: The plan administrator can reasonably assume a distribution is eligible for rollover, but those regulations do not apply to an IRA trustee. The distributee may need some information from the plan administrator in order to know when the 60 day rollover period lapses, but they don't need to provide anything to the IRA trustee unless the trustee has internal administrative procedures requiring such documentation.

20. **§410(b) – Minimum Coverage Requirements**

After a disposition, the seller spins off a portion of its plan covering the affected employees and transfers the plan to the buyer. Is the spun-off/transferred plan otherwise eligible for the relief afforded by §410(b)(6)(C)?

Proposed Response: Yes. The relief afforded by §410(b)(6)(C) goes to "any plan" sponsored by "a person [who] becomes, or ceases to be, a member of a group described in subsection (b), (c), (m), or (o) of §414." The spun-off plan was sponsored by an employer who ceased to be a member of a controlled group of businesses. The fact that sponsorship of the plan was transferred from the seller to the buyer is not a "significant change in the plan or in the coverage of the plan" as described by Treas. Reg. §1.410(b)-3(f) that would terminate the end of the transition period.

IRS Response: The IRS agrees with the proposed response.

21. **§411(b) – Accrual Rules**

Can a plan that is amended to provide for a future service only increase in benefits comply with the accrual rules? For example, assume a collectively bargained plan that provides for a $40/per year of service benefit formula is amended to provide a $70/per year of service benefit for years of service after 2001. Does such a benefit formula satisfy the §411(b) accrual rules?

Proposed Response: Yes, such a benefit formula satisfies the 133 1/3 accrual rule. Treas. Reg. §1.411(b)-1(b)(2)(ii)(A) indicates that any amendment that is in effect for the current plan year shall be treated as if it were in effect for all other plan years. The regulation is not limited to amendments that apply benefit increases to all years of service, it applies to "any amendment." The benefit formula would be tested under the 133 1/3 accrual rule as if the $70/per year of service formula applies to all years of service, and therefore satisfies the accrual rule.

IRS Response: The IRS agrees with the proposed response. There is an example to this effect in the legislative history to ERISA.

22. **§411(d)(3) – Partial Plan Termination**

Must a multiemployer plan provide for full vesting upon the withdrawal of an employer from the plan under the partial termination rule?

There appears to be a contradiction between ERISA and the Code. See §411(d)(3)(A) and ERISA §203(a)(3)(E)(i). The problem is that in any multiemployer plan, there are employers that withdraw for any one of a number of reasons -voluntarily, bankruptcy, union disaffiliation, etc. Full vesting of these employees is not desired by the parties. In fact, ERISA §203(a)(3)(E)(i) provides that "A right to an accrued benefit derived from employer contributions under a multiemployer plan shall not be treated as forfeitable solely because the plan provides that benefits accrued as a result of service with the participant's employer before the employer had an obligation to contribute under the plan may not be payable if the employer ceases contributions to the multiemployer plan." There is no comparable Code provision.

The inference is that Congress did not intend that §411(d)(3)(A) would apply in case of the withdrawal of an employer from a multiemployer plan. Probably, the issue was not fully considered when ERISA was passed nor in the course of making later amendments to the Code and ERISA.

Proposed Response: Withdrawal of a single employer from a multiemployer union negotiated plan is not per se a partial termination.

IRS Response: The IRS noted that Code §411(a)(3)(E) matches ERISA §203(a)(3)(E)(i). The basic rule is that a partial termination is a facts and circumstances determination based on all participants who share the same benefit formula in the multiemployer plan. The fact that a complete entity is leaving is relevant to the determination, just like a plan shutdown event is relevant in determining whether a partial termination has occurred in a single employer plan, but it is not dispositive.

23. **§411(d)(6) – Anticutback Rule**

Final regulations issued September 6, 2000 allow for the elimination of optional forms of benefit under §411(d)(6). These regulations allow for the elimination of annuity forms of distribution in profit sharing plans as long as (a) a single-sum distribution form that is otherwise identical to the annuity form remains in the plan; (b) certain timing requirements are met; and (c) the plan is not subject to §401(a)(11)(B). May a plan that had formerly chosen to be subject to §401(a)(11)(B), even though not required (*i.e.*, the "normal" form of distribution under such plan was the QJSA) eliminate annuity forms of distribution?

Proposed Response: Yes. Regardless of whether an annuity or a single-sum is the normal/default form of distribution under the plan, as long as the timing and other requirements of the new regulations are met, the annuity form may be eliminated.

IRS Response: The IRS agrees with the proposed response. Sections 411 and 417 do not require keeping the benefit, even though it was the normal form of benefit. A participant who has elected a form of distribution is covered and must be allowed to receive the benefit, but it need not be saved for other participants.

24. **§411(d)(6) – Anticutback Rule & Adoption of GATT Rates**

If a plan has no lump sum options other than mandatory cash-outs for amounts under $5,000, must a "non-PBGC" interest rate be protected when switching to GATT rates? For example, if a plan uses whichever gives larger lump sum:

a. PBGC rates in effect on 1st day of plan year, or

b. 6%

Proposed Response: The cash-out of a benefit with a present value of less than $5,000 permitted under §417(e)(1) is not a protected benefit and may be removed from a plan, according to Treas. Reg. 1.411(d)-4, Q&A 2(b)(2)(v). Additionally, Rev. Rul. 81-12 indicates that actuarial factors used in determining optional forms of benefit are not protected by §411(d)(6), but normally the value of the accrued benefit determined using those factors are protected. Accordingly, if the benefit is not protected because it is below the involuntary cash-out limit, the actuarial factors can be changed without regard to §411(d)(6). Both rates could be eliminated and replaced with GATT rates for determining the value of small lump sum cash-outs.

IRS Response: The IRS disagrees with the proposed response.

25. **§415 – Limitation on Contributions and Benefits**

How is §415 compensation and the corresponding limitations on contributions and benefits determined for a participant who changes from employee status to partner/self-employed status during the year? For example, assume a participant works for an employer as a employee for a portion of a year, makes $40,000 in wages and makes elective deferrals into the firm's §401(k) plan. During the year, the participant attains partner status, with a corresponding change to earned income. Because of a one-time charge to the partnership, the participant's earned income for the year is a $45,000 loss. Must the plan refund all the elective deferrals to the participant as excess annual additions?

Proposed Response: None.

IRS Response: The individual's compensation for §415 purposes is zero. The contributions for the individual are §415 excess annual additions and must be refunded to the participant. Section 415 compensation doesn't go below zero, but if the participant has net zero total wages and earned income, the corresponding annual addition for that year is zero.

26. **§415 – Limitation on Contributions and Benefits**

When the Section 415 limitation for defined contribution plans is exceeded, and elective deferrals are distributed to employees, are the elective deferrals reduced by losses attributable to the deferred amount?

Treas. Reg. §1.415-6(b)(6)(iv) provides that a "plan may provide for the distribution of elective deferrals (within the meaning of §401(g)(3)) or the return of employee contributions (whether voluntary or mandatory), and for the distribution of gains attributable to those elective deferrals and employee contributions, to the extent that the distribution or return would reduce the excess amounts in the participant's account."

Proposed Response: When elective deferrals have incurred a loss prior to distribution, a distribution of elective deferrals unreduced by losses would be unfair to participants. When elective deferrals have been reduced by losses, the distribution of elective deferrals can be reduced by such losses.

IRS Response: The IRS disagrees with the proposed response. If the amount of excess annual additions is $4,000 and the plan suffers a 10% loss, the amount of the corrective distribution is $4,000.

27. **§417 – Annuity Starting Date**

A defined benefit pension plan requires that benefits for a terminated participant be payable no later than the first day of the month following the month the participant attains age 65. A participant may elect to take a lump sum in lieu of a single life annuity or a QJSA if the participant is married. The lump sum is valued on the basis of the GATT rate for the plan year in which the annuity starting date occurs. An employee advises the administrator that he will terminate on his 65th birthday in November. Due to delays caused by the plan and the participant, employee election notices are not furnished until December 15 and the lump sum is not actually paid until February 1. The GATT rate has changed from the year of retirement to the year of actual payment, causing a reduction in the amount of the lump sum. The administrator computes the lump sum on the basis of the GATT rate for the year of actual payment. The participant claims that GATT rate for the year of retirement should be used because the annuity starting date falls in that year. The administrator states the plan does not recognize retroactive annuity starting dates. Who is right?

Proposed Response: The participant is correct. The plan states that the lump sum is valued using the GATT rate for the plan year in which the annuity starting date occurs. Since the plan states that the benefit is payable as of the first day of the month following the attainment of age 65, then December 1 of the year of retirement is the annuity starting date and the GATT rate for that year should be used. The amount of the benefit in this situation should not fluctuate because of the vagaries of the administrative process.

IRS Response: The IRS believes it is an unusual plan design to set an annuity starting date without the participant asking for the distribution, and believe this is a poor plan design. If the annuity starting date is reached and the participant can't be found, the plan fails to make a distribution in accordance with its terms and should enter the EPCRS program to correct the discrepancy between plan documentation and operation.

28. **§417 – Qualified Joint and Survivor Annuity Requirements**

Can a QJSA have a term certain payment period or other additional guaranteed death benefit? For example, can a 10 year certain and continuous benefit be a QJSA for an unmarried participant?

Proposed Response: Yes. The addition of another survivor benefit does not preclude an annuity benefit that otherwise satisfies the requirements of a QJSA from being a QJSA.

IRS Response: The IRS agrees with the proposed response and noted there is an example in the §415 regulations that deals with the optional form described in the question, indicating that the plan has to adjust for the 10 year certain benefit feature but not for the survivor annuity feature.

29. **§417 – Qualified Joint and Survivor Annuity Requirements**

Does the Defense of Marriage Act affect a qualified plan's ability to offer a joint and survivor annuity benefit with a non-spousal beneficiary?.

Proposed Response: No. The Defense of Marriage Act (1 U.S.C.A. §7, 28 U.S.C.A. §1738C) indicates that a "marriage" means only a legal union between one man and one woman as husband and wife, and the word "spouse" refers only to a person of the opposite sex who is a husband or a wife. A qualified joint and survivor annuity (QJSA) is defined by §417(b) as an annuity "for the life of the participant with a survivor annuity for the life of the spouse which is not less than 50 percent of (and is not greater than 100 percent of) the amount of the annuity which is payable during the joint lives of the participant and spouse."

But the requirement that a QJSA have a spouse as the survivor beneficiary does not preclude a qualified plan from offering another joint and survivor annuity with a non-spousal beneficiary. The ability to designate a non-spousal beneficiary does not violate any provision of the Internal Revenue Code or the Defense of Marriage Act.

IRS Response: The IRS agrees with the proposed response. Nothing precludes a joint and survivor benefit with a non-spousal beneficiary. Such a distribution option won't be a QJSA within the meaning of §417, but there is nothing wrong with having a participant's child, grandchild, sister-in-law, or domestic partner being a contingent annuitant in a pension plan.

30. **§3121(v) – FICA Taxation of Nonqualified Deferred Compensation**

Effective January 1, 2000, a nonqualified plan promises a flat annual benefit payable for 15 years, commencing at normal retirement age. Each year a liability account is charged with an expense calculated pursuant to FASB 87. The terms of the plan provide that the participating officer has a nonforfeitable right to an amount equal to the liability account.

In accordance with generally accepted accounting principles, the annual expense calculation includes both a service and interest component. For example, the annual expense for the year 2000 for a participant born 11/11/48 with an annual 15 year retirement benefit of $26,950 commencing at age 62, assuming an annual discount rate of 8.25%, is $9,759, consisting of a service component of $9,360 and an interest component of $398. Attached is a schedule illustrating the expense calculations. At the end of 2000, the participating officer has a vested right to the total liability account of $9,759.

The plan sponsor wants to satisfy the nonduplication rule of Treas. Reg. §31.3121(v)(2)-1(a)(2)(iii) by satisfying the "taken into account" requirement. On the other hand, it does not want to include in the officer's FICA wage base any amount that is not otherwise required. If the "taken into account" requirement can be satisfied by including only the service component of the annual expense (*i.e.*, $9,360 in the example), the sponsor would obviously want to do so.

Proposed Response: The nonduplication rule generally provides that "[o]nce an amount deferred under a nonqualified defined contribution plan is taken into account..., then neither the amount taken into account nor the income attributable to the amount taken into account... is treated as wages for FICA purposes at any time thereafter." Treas. Reg. §31.3121(v)(2)-1(a)(2)(iiii).

The "amount deferred" for a nonaccount balance plan equals "the present value of the additional future payment or payments to which the employee has obtained a legally binding right...during that period." Treas. Reg. §31.3121(v)(2)-1(c)(2)(i). Present value must be determined "using actuarial assumptions and methods that are reasonable as of that date." Treas. Reg. §31.3121(v)(2)-1(c)(2)(iii). "Income" for a nonaccount balance plan means "the increase, due solely to the passage of time, in the present value of the future payments to which the employee has obtained a legally binding right, the present value of which constituted the amount taken into account..., but only if the amount taken into account was determined using reasonable actuarial assumptions and methods." Treas. Reg. §31.3121(v)(2)-1(d)(2)(ii).

The plan is a "nonaccount balance plan" because it promises a flat benefit. The fact that the vesting provisions of the plan grant nonforfeitable rights based upon the liability account does not convert this flat benefit pension plan from a "nonaccount balance plan" to an "account balance" plan.

The projected unit credit method of accounting for pension liability contained in FASB 87 is a "reasonable actuarial...method". It requires both a service and interest expense to be recognized each year. The interest component is "due solely to the passage of time".

Accordingly, only the service component of the annual expense is the "amount deferred". In this example, inclusion of $9,360 in the officer's 2000 taxable wage base will satisfy the nonduplication rule of Treas. Reg. §31.3121(v)(2)-1(a)(2)(iii).

IRS Response: The IRS noted it is sometimes hard to characterize nonqualified plans as account balance or nonaccount balance plans. This particular plan design appears to be an account balance plan, because the benefit the participant has a legal entitlement to is defined as the liability account that grows with interest. That design fits the definition of an account balance plan.

31. **§4980B – Continuation Coverage**

Medical expense reimbursement plans (also called "health FSAs") are subject to the COBRA continuation coverage requirements of §4980B. Generally, this statute requires that COBRA continuation coverage be offered to each "qualified beneficiary" – a term that includes the employee, the employee's spouse and the employee's dependent children. If the employee does not elect COBRA continuation coverage for a medical expense reimbursement plan upon the occurrence of a qualifying event, may the employee's spouse or the employee's dependent?

Proposed Response: No. A medical expense reimbursement plan by definition (§105(h)(6)) may reimburse only employees for medical expenses. This is different than other group health plans that may provide coverage to employees and their spouses and dependents on equal footing. Therefore, only the employee can elect to continue coverage under a medical expense reimbursement plan.

IRS Response: The IRS disagrees with the proposed response. A medical expense reimbursement plan can reimburse the expenses of employees and their spouses and dependent children. Regardless of whether reimbursements made to spouses and dependent children for their medical expenses are subject to favorable tax treatment under §105(b), a plan providing those reimbursements to an active employee provides coverage to a spouse or dependent child for purposes of §4980B. Thus, if a qualifying event would cause a plan to cease reimbursing those expenses, then the spouse or dependent child has experienced a qualifying event and is a qualifying beneficiary entitled to elect continuation coverage under the medical expense reimbursement plan.

32. **§7805(b) – Employee Plans Compliance Resolution System**

The various revenue procedures containing EPCRS have always contained a list of mitigating factors that, if applicable, would reduce the employer's sanction under Walk-in CAP below the presumptive amount. No official list of aggravating factors has ever been published, although one could assume that if egregious violations were present, that would be an aggravating factor.

In at least one recent Walk-in CAP submission, the IRS has imposed sanctions in excess of the presumptive amount because both form and operational defects were present (the absence of both form and operational defects is a mitigating factor), even though other mitigating factors were present. Does this mean that the absence of any one mitigating factor will result in a sanction in excess of the presumptive amount? What other aggravating factors does the IRS use in determining the amount of a Walk-in CAP or TVC Program sanction?

Proposed Response: None.

IRS Response: Rev. Rul. 2000-17 list factors that the IRS will consider when determining whether a VCP compliance fee should be equal to, greater than or less than the presumptive amount. Whether these factors are mitigating or aggravating depends on the facts and circumstances of each VCP submission.

33. **§7805(b) – Employee Plans Compliance Resolution System**

Can you confirm that the Service anticipates that a VCP submission will begin with a proposed correction by the submitter and end with an agreed upon compliance statement after drafts have been exchanged, conversations have occurred, and meetings have been held, all as needed?

Proposed Response: Yes. Consistent with Rev. Proc. 2001-17, §§ 10.06(2) and 10.06(5), the Service anticipates a process of dialogue and exchange of drafts, including meetings where necessary, to finalize a compliance statement, whether the submission is made to the National Office or a district office, whether the submission is made by an individual plan sponsor or an Eligible Organization, and regardless of the particular program in VCP. Such dialogue is consistent with the underlying purpose of EPCRS to encourage and strengthen voluntary corrections and compliance.

IRS Response: The IRS is going to continue its same procedures for individual submissions, including the process of dialogue and exchange of drafts of compliance statements.

34. **§7805(b) – Employee Plans Compliance Resolution System**

What are the factors that the Service will consider in deciding whether to allow the addition of new qualification failures after a VCP submission has been made?

Proposed Response: In addition to considering how close the Service and the submitter are to finalizing a compliance statement as provided in Rev. Proc. 2001-17, § 10.06(4), the Service will also consider the costs to the plan sponsor(s) of making two sets of corrections and the disadvantages to participants of two sets of corrections. The Service will afford greater flexibility for new qualification failures that affect some or all of the same participants affected by the pending submission. VC Group submissions will be given additional flexibility, given the efficiencies achieved by the VC Group process and the potentially greater number of participants affected. The Service may condition its exercise of discretion on payment of additional fees.

IRS Response: Section 10.06(4)(a) provides that a plan sponsor that discovers additional failures after filing an application may request that the failures be included in the submission. The IRS is flexible in allowing plan sponsors to include additional failures. The IRS retains the discretion to reject the inclusion and may ask for an additional fee.

35. **§7805(b) – Employee Plans Compliance Resolution System**

Does the representative of the plan sponsor who is signing the penalty of perjury statement or signing the compliance statement have to be a fiduciary of the plan?

Proposed Response: No. The individual signing on behalf of the plan sponsor for both the compliance statement and the penalty of perjury statement should be an individual who has authority to bind the plan sponsor. There is no requirement that the individual sign in a fiduciary capacity. While a principle of VCP is that all qualification failures should be fully corrected for all affected participants for all affected years, the Service recognizes that the costs and benefits of full correction in certain situations warrant exceptions to the full correction principle. An individual acting as a fiduciary, however, has to evaluate the responsibility to seek full correction under ERISA. Such an evaluation may or may not be different than the analysis of a plan sponsor that is working with the Service to agree on any appropriate exceptions to the full correction principle under EPCRS.

IRS Response: The responsible party who signs the penalty of perjury statement must be the plan sponsor.

36. **§7805(b) – Employee Plans Compliance Resolution System**

Will the Service consider allowing correction through a retroactive amendment in additional situations for VCO and SCP?

Proposed Response: Yes. The Service will allow correction through amendment for VCO and SCP where the error is an Operational Failure and the amendment meets the criteria of Rev. Proc. 2001-17, § 4.06(1).

The Service will also provide guidance through giving additional examples of specific problems where retroactive amendments can be made, including (i) the failure to use the correct period for measuring compensation when making matching or other contributions (for example matched contributions are made each payroll and are based on payroll compensation as opposed to plan year compensation; however, the plan either does not precisely define the period of compensation or defines the period as the plan year); (ii) the components of compensation used to calculate contributions were not those set forth in the plan (for example, the plan includes all W2 compensation; however, in practice, income from the exercise of nonqualified options is excluded, and such exclusion primarily impacts HCEs and both the stated and used definitions comply with §414(s)); and (iii) the plan sponsor has allowed loans on a non-discriminatory basis in accordance with both ERISA and the Code, identified loans as available in communications made to participants, but did not set forth loan provisions in the plan. In each of these situations, a retroactive amendment is allowed by VCO and SCP. Further, these examples are not exclusive.

IRS Response: The IRS will consider these additional ideas.

37. **§7805(b) – Employee Plans Compliance Resolution System**

Will a plan sponsor that has contracted with an Eligible Organization to receive a particular administrative service be considered to have a procedure with respect to that service for purposes of determining eligibility for SCP?

Proposed Response: Generally, yes. If the plan sponsor has contracted for an administrative service, the contract should generally be treated as an administrative procedure. The Service has discretion to find otherwise where a context specifies certain steps to be taken by the plan sponsor (for example, to provide data to the service provider) and there is a consistent failure by the plan sponsor to attempt the specified steps.

IRS Response: The plan administrator must have established practices and procedures designed to promote compliance. Plan documents are not enough. Whether a service agreement is sufficient depends on the terms of the contract and whether the terms were routinely followed.

38. **§7805(b) – Employee Plans Compliance Resolution System**

Will the Service consider a single VC Group submission by an Eligible Organization that is both a M&P sponsor and a provider of administrative services that covers both Document and Operation Failures that are related and which affect the same group of plan sponsors?

Proposed Response: The Service will allow such a single submission. There are many organizations that both sponsor M&P plans and which provide administrative services to Qualified Plans. It is possible that an Eligible Organization could have clients which are affected both by a systematic Plan Document Failure and by one or more Operational Failures. It will be efficient for each of the Service, the Eligible Organization and affected plan sponsors to have related problems reviewed at the same time by the same individual(s) within the National Office. The Service has discretion to charge additional fees for this type of situation.

IRS Response: The IRS appreciates the comment.

39. **§7805(b) – Employee Plans Compliance Resolution System**

Will the Service consider reviewing a VC Group submission for fewer than 20 plans if a higher fee is paid (*e.g.*, a higher base fee than $10,000)?

Proposed Response: Yes. The Service recognizes that there is currently a huge discount in fees for VC Group over the sum of fees for individual submissions, particularly where larger plans are involved. The Service believes that some Eligible Organizations (and plan sponsors) might be willing to pay a base fee that starts higher for plans fewer than 20, given the efficiencies for each of the Service, the Eligible Organization, and plan sponsors in having a single review process and consistent correction. Therefore, the Service will consider reviewing a VC Group submission for fewer than 20 plans if a higher base fee is paid. The Service will identify the fees for this situation shortly.

If a VC Group submission is made with respect to 20 or more plans and by the time that the compliance statement is agreed to, there are fewer than 20 plans covered, the Service will not charge a higher fee; however, neither will it refund or reduce the additional fee that is payable upon agreement to the compliance statement. The Service recognizes that the number of plans covered by a VC Group submission can change because of changes in the relationship between the Eligible Organization and the plan sponsor, and because the plan sponsor may choose to make a different correction than that agreed to by the Eligible Organization.

IRS Response: The volume submitter program requires 20 plans, but the IRS will consider future revisions to the program. Alternatively, the taxpayer can come in for a closing agreement with fewer plans. Also, if a VC Group submission initially includes 20 or more plans, but fewer than 20 plans ultimately follow through to the compliance statement stage, the submission can continue to be treated as a VC Group submission.

40. **§7805(b) – Employee Plans Compliance Resolution System**

Can you confirm that a submission for a Document Failure assumes the Qualified Plan has been operated correctly and is outside the §401(b) period, and that the only consequence of making the submission will be to obtain IRS approval of the retroactive amendment and payment of the fee for the submission?

Proposed Response: Yes.

IRS Response: The IRS agrees with the proposed response, assuming the plan is operated within the terms of the law and not the plan document.

The preceding questions and answers are based on informal discussions between private sector representatives of the JCEB and Treasury Department and IRS 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 discussions 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 IRS or Treasury. The questions were submitted in advance to the agencies, and it was understood that this report would be made available to the public.