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AMERICAN BAR ASSOCIATION

SECTION OF TAXATION

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COMMITTEE ON EMPLOYEE BENEFITS

JOINT COMMITTEE ON EMPLOYEE BENEFITS

INTERNAL REVENUE SERVICE

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*The following questions and answers are based on an oral presentation made by IRS and Treasury officials at the Tax Section's Employee Benefits Committee meeting on May 10, 2013. The statements contained herein cannot be relied on even though they are printed as statements of the IRS. The questions were submitted by ABA members, and the responses were given at such meeting after explicit statements that their 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 responses was prepared by designated JCEB representatives, based on the notes and recollections of the JCEB representatives at the meeting and on a review of audio tapes of the meeting. This report has not been reviewed by IRS or Treasury. The questions were submitted in advance to the agency, and it was understood that this report would be made available to the public.*

## 1. § 1(f)(3) – Cost of Living Adjustments

Beginning with the 2014 plan year, group health plans will be subject to the same annual limit on cost sharing to which high deductible health plans are subject in that year (Affordable Care Act § 1302(c)(2), implemented by 45 C.F.R. § 156.130, 78 Fed. Reg. 12,867 (Feb. 25, 2013)). However, for 2015 and future years, the ACA’s out of pocket maximum for group health plans will be adjusted by HHS based on “the percentage (if any) by which the average per capita premium for health insurance coverage for the preceding calendar year exceeds such average per capita premium for health insurance for 2013.” 45 C.F.R. § 156.130(d),(e).

High deductible health plans are group health plans when offered by or on behalf of employers or employee organizations. However, the Internal Revenue Code requires annual adjustments to the out of pocket maximum for those plans to be calculated based on the cost of living adjustment determined under Section 1(f)(3) of the Code, which relies on the Consumer Price Index for all Urban Consumers. Consequently, the IRS and HHS adjustments are likely to differ.

If the HHS adjustment creates a higher out of pocket maximum than the IRS adjustment, must a high deductible health plan, which also is a group health plan, adhere to the IRS adjustment?

**Proposed Response:** High deductible health plans must adhere to the IRS adjustment. The U.S. Supreme Court has held that

It is a basic principle of statutory construction that a statute dealing with a narrow, precise, and specific subject is not submerged by a later enacted statute covering a more generalized spectrum. “Where there is no clear intention otherwise, a specific statute will not be controlled or nullified by a general one, regardless of the priority of enactment.” *Morton v. Mancari*, 417 U.S. 535, 550-551. “The reason and philosophy of the rule is, that when the mind of the legislator has been turned to the details of a subject, and he has acted upon it, a subsequent statute in general terms, or treating the subject in a general manner, and not expressly contradicting the original act, shall not be considered as intended to affect the more particular or positive previous provisions, unless it is absolutely necessary to give the latter act such a construction, in order that its words shall have any meaning at all.” T. Sedgwick, *The Interpretation and Construction of Statutory and Constitutional Law* 98 (2d ed. 1874).

*Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 153, 96 S. Ct. 1989 (1976).

**IRS Response:** A high deductible health plan that is a group health plan will generally be subject to both the out-of-pocket maximum for high deductible health plans under Section 223 and the out-of-pocket maximum for group health plans under Section 1302(c)(1) of the Affordable Care Act (via Section 2706(b) of the Public Health Service Act). If two different out-of-pocket maximum levels apply to a plan, the plan complies with both if it complies with the lower out-of-pocket maximum. Thus, in the case of a high deductible health plan subject to the maximum out-of-pocket limit under Section 223 and the maximum out-of-pocket limit under Section 2706(b) of the Public Health Service Act, the plan must comply with the lower amount. In any event a high deductible health plan must satisfy the maximum out-of-pocket limit under Section 223 in order to be a high deductible health plan supporting an HSA.

## 2. § 72(p) – Collateral for Plan Loan

Assume that a participant has an account balance of \$100,000 in his defined contribution account. He requests and receives a loan of \$50,000 that complies with Section 72(p) of the Code. Before the loan is paid back, the plan receives a qualified domestic relations order that awards the participant's former spouse \$50,000 of his account balance from the plan, to be paid from assets other than the plan loan. The qualified domestic relations order also provides, consistent with the terms of the plan, that the distribution should be made as soon as administratively feasible after the domestic relations order is determined to be a qualified domestic relations order. Can the plan make an immediate distribution to the alternate payee?

**Proposed Response:** No. The loan is required to be secured by the participant's account balance. A distribution of \$50,000 to the alternate payee would result in the participant's account balance equaling \$50,000, all of which would be attributable to the outstanding loan. Accordingly, the alternate payee's share of benefits must continue to serve as security for the loan until either (i) the loan is repaid or (ii) there are sufficient assets in the participant's account to serve as security for the loan.

**IRS Response:** The Service representative disagrees with the proposed response. Section 72(p)(2)(A) provides that a loan is taxable unless it is secured by the participant's account balance and the loan does not exceed 50% of the account balance, among other limitations. The most recent valuation of the accrued benefit is used to determine whether that 50% requirement is satisfied. Changes to the account balance after the inception of the loan are not relevant to whether those requirements are satisfied. Unless the loan is later renegotiated, renewed or modified, there would not be any problem with that distribution from the account. Notice 82-22 discusses the renegotiation, renewal or modification rule. The Service representative also noted that he was not authorized to speak for Department of Labor and that the Department of Labor may have a point of view on this issue.

## 3. § 401 – Benefit Election Following Reemployment

A participant retires prior to his normal retirement date and elects, with spousal consent, a joint and survivor option. He thereafter returns to work for three months, prior to normal retirement age, and his benefit is suspended during the time of his reemployment. Once he stops working, his benefit is recalculated to include a small accrual earned during this period of reemployment. Is a second annuity starting date, for which new elections for the survivor annuity must be offered, required for the accruals earned during reemployment?

**Proposed Response:** No. Treasury Regulation Section 1.401(a)-20, Q&A 10(d)(1) does not require a new annuity starting date for the accruals earned during reemployment.

**IRS Response:** The Service representative disagrees with the proposed response. Treasury Regulation Section 1.401(a)-20 provides very explicit relief from the second annuity starting date only for post-normal retirement age additional accruals. The regulations explicitly carve out pre-normal retirement age additional accruals.

## 4. § 401 – Correction for Exclusion from Plan

A 401(k) plan has a matching contribution that is made on a **plan year** basis. An employee is erroneously excluded from making elective deferrals to the plan for the first two (2) months of the plan year. Under EPCRS, no correction for the missed deferral opportunity is required since the

employee has 10 months (more than 9 required in Rev. Proc. 2013-12) in the plan year to make elective deferrals up to the maximum amount permitted under the Plan.

Employee elects to contribute “0” or an amount that does not provide him with the maximum match from 03/01 to 12/31. Does EPCRS require the employer to provide a QNEC to the employee for the failure to provide the employee the opportunity to receive matching contributions on the deferrals that could have been made during the first 2 months of the plan year (using the ADP for the employees group)?

**Proposed Response:** Appendix B, Section 2.02(b), example 7, provides a sample correction using a plan that provides for matching contributions **each payroll period**. Since the matching contribution in this fact pattern is made on a **plan year** basis and not payroll period, and the employee had the opportunity to make the maximum deferral amount and thereby receive the maximum matching contribution, EPCRS does not require the employer to make a QNEC for the failure to receive the maximum matching contribution provided under the Plan.

**IRS Response:** The Service representative disagrees with the proposed response. The Service representative stated that this is not how the Revenue Procedure reads. The Service representative noted that this is a facts and circumstances issue and that if the plan were submitted under the Voluntary Correction Program, there might be a different result.

#### **5. § 401 – Determination Letter Applications: Amendments Adopted After Plan Restatement**

Under the new determination letter filing procedures beginning with Cycle C (which began February 1, 2013) an employer requesting a favorable determination letter must submit a plan “restatement” and it appears that the employer cannot submit a working copy of the plan that includes all previously adopted amendments. Specifically, all references to “working copies” have been deleted from Rev. Proc. 2013-6. If a plan is restated on December 31, 2013 (near the end of Cycle C) and the employer decides to adopt a subsequent plan amendment on January 15, 2014 (prior to filing the plan on January 31, 2014 for a determination letter request), does the plan have to be restated again to include the subsequent January 15, 2014 amendment? If not, does a working copy of the plan have to be submitted with the filing application to include the January 15, 2014 amendment or will the Service accept the plan restatement and the subsequent January 15, 2014 amendment as a “stand alone” document?

**Proposed Response:** The Service will accept the separate amendment as a “stand alone” document without having it included in a “restatement” or working copy of the plan.

**IRS Response:** An amendment must be included in a restated document in order to be considered for a favorable determination letter.

#### **6. § 401 – Inability to Submit Missing Executed Plan Documents With a Determination Letter Request**

An employer merges an acquired company’s pension plan into the employer’s plan. The acquired company’s pension plan received a favorable determination letter before it was merged into the employer’s pension plan, however, after receiving the determination letter, the acquired company adopted an amendment to reflect a change in law. The executed copy of such amendment cannot be located. When the employer submits the merged plan to the Service for a determination letter, the employer is not able to submit an executed copy of the relevant plan amendment since it cannot

be located. It is our understanding that the Service will not consider a request for a favorable determination letter unless the employer submits all executed plan documents back to the date of the last favorable determination letter or, in the case of a prototype plan that relies on a favorable opinion letter, the employer submits all executed plan documents and amendments back to the date of the plan's initial adoption. How can the employer address this situation so that the Service will consider its request for a favorable determination letter?

**Proposed Response:** The Service will instruct its agents that they are authorized to consider determination letter requests where the requesting employer cannot produce executed plan amendments or plan documents for reasons beyond the control of the employer. The employer will be deemed to satisfy this condition if the employer provides a written certification to the Service that states that the employer undertook a reasonable process to locate the executed amendments or plan documents, the plan was administered in accordance with the relevant amendments and documents and the employer could not locate the amendments or plan documents due to the reasonable circumstances set forth in the written certification.

**IRS Response:** The Service representative disagrees with the proposed response. The applicant must submit documentation to show timely compliance with applicable law. If old documentation is not available that is still necessary, the sponsor has the option of treating it as a plan document failure and filing under the Voluntary Correction Program. In situations where the required documentation is not available, but a sponsor can provide contemporaneous insularly documentation supporting timely amendment then that is something that the sponsor would want to disclose in the determination letter application. Ultimately, it will be a facts and circumstances decision in the determination letter process whether that documentation is sufficient.

## 7. § 401 – Off-Cycle Determination Letters

A defined benefit plan decided in 2013 to convert its traditional defined benefit plan into a cash balance plan. The defined benefit plan previously adopted a pre-approved document. Since the Plan was pre-approved, the sponsor chose not to file for a determination letter during the last pre-approved cycle that ended on April 30, 2012. After the conversion, the individually designed plan will fall in Cycle A, meaning it will not be on-cycle for a determination letter until 2016. Because of the uncertainty surrounding cash balance plans, the sponsor would like to submit the plan in 2013, which will be off-cycle. If the sponsor submits the plan off-cycle, will the IRS give the submission the same priority as an on-cycle plan?

**Proposed Response:** Yes, the IRS will give it the same priority as an on-cycle plan. The conversion from a traditional defined benefit plan to a cash balance plan is an urgent business need. Accordingly, the sponsor may submit the cash balance plan for a determination letter in 2013.

**IRS Response:** Urgent business need is a question of facts and circumstances. The urgent business need exception will only apply in limited cases where exceptional circumstances exist. The Service representative noted that “uncertainty surrounding cash balance plans” does not appear to be an urgent business need.

## 8. § 402(a) – Correction of Overpayments with Spouse as Joint Annuitant

Participant in a defined benefit plan is receiving a joint and 50% survivor annuity with a spouse beneficiary. The plan sponsor discovers that payments during the joint lives were miscalculated and overpayments were made. Using the adjustment of future payments correction method under

Rev. Proc. 2013-12, payments are reduced over the joint lives of the participant and beneficiary. Participant dies before the full amount of the overpayment is recouped by the plan.

Based on these facts, can the surviving spouse benefit be reduced to recoup the remaining overpayment amount?

**Proposed Response:** Yes. The Employee Plans Compliance Resolution System (“EPCRS”) correction requires the spousal survivor benefit to be determined as 50% of the correct joint life payment (not 50% of joint life payment with reduction for overpayment). This correction, however, does not preclude reducing the survivor portion to recover the remaining overpayment amount.

**IRS Response:** The Service representative disagrees with the proposed response. The spouse’s survivor benefit cannot be reduced. See the rules of general applicability contained in Section 6.06(3) (Correction of Overpayment (defined benefit plans)) of Revenue Procedure 2013-12, which states that the correction should be in accordance with “rules similar to the Return of Overpayment and Adjustment of Future Payments correction methods described in section 2.04(1) of Appendix B.” The methods contained in Section 2.04(1) of Appendix B are the 415(b) safe harbor correction methods.

#### **9. § 402(a) – Correction of Overpayments with Non-Spouse Joint Annuitant**

This is similar to the preceding question. Participant in a defined benefit plan is receiving a joint and 50% survivor annuity with a non-spouse beneficiary. The plan sponsor discovers that payments during the joint lives were miscalculated and overpayments were made. Using the adjustment of future payments correction method under Rev. Proc. 2013-12, payments are reduced over the joint lives of the participant and non-spouse beneficiary. Participant dies before the full amount of the overpayment is recouped by the plan.

Based on these facts, can the non-spouse beneficiary benefit be reduced to recoup the remaining overpayment amount?

**Proposed Response:** Yes. In this case, the non-spouse benefit can be reduced to recoup the remaining overpayment amount.

**IRS Response:** The Service representative agrees with the proposed response. The benefit payable to the survivor may be reduced going forward. The Appendix B correction method cited in the previous question as applied to the survivor annuity payments of a non-spouse beneficiary is not restricted as the survivor benefit to the spouse beneficiary, which is a requirement under 2.04(1)(a)(ii)(B), so one could recoup in that case.

#### **10. § 402A – Merger of Plan with Roth Contributions**

Can a plan that permits Roth contributions be merged into a plan that does not contain a Roth contribution provision? A Roth contribution provision will not be added to the successor plan as a result of the merger.

**Proposed Response:** Yes. A plan that has a Roth contribution provision can be merged into a plan that does not contain a Roth contribution provision at the time of or subsequent to the merger. However, the Roth contribution feature must be suspended (eliminated) prior to or as part of the plan merger.

**IRS Response:** The Service representative indicated that they were not able to gather a consensus to respond to this question, but noted that if this question is submitted again next year, they will likely be able to respond.

#### **11. § 409A – Definition of Plan**

For purposes of §409A plan aggregation, elective deferral account balance plans are distinguished from account balance plans under which contributions are not due to deferral elections (“employer contribution plans”). Many “employer contribution plans” offer participants choices of deferred payment options, such as lump sum after a specific date in a following year or multi-year installments after separation from service.

Provided that an “employer contribution plan” does not offer a current year taxable payment choice, please confirm that deferred payment options do not cause an “employer contribution plan” to be considered an elective deferral account plan.

**Proposed Response:** Provided that a currently taxable option is not available, an “employer contribution plan” with various deferred payment choices will not be considered an elective deferral plan.

**IRS Response:** The Service representative agrees with the proposed response. A choice of form of payment alone will not cause an employer contribution plan to be categorized as an elective deferral plan.

#### **12. § 409A – Plan Termination**

Termination of a plan is not a prohibited acceleration provided that *“the service recipient terminates and liquidates all agreements, methods, programs, and other arrangements that would be aggregated with any terminated and liquidated agreements, methods, programs, and other arrangements under §1.409A-1(c) if the same service provider had deferrals of compensation under all the agreements, methods, programs, and other arrangements that are terminated and liquidated.”*

Would it be necessary to terminate all plans of the same type in order to fit within this exception, including plan for which the service provider was not eligible?

**Proposed Response:** It is not necessary to terminate each plan of the same type for all service providers within a controlled group. It is necessary to terminate all plans of the same type in which a service provider has participated, or is eligible to participate. In other words:

- A voluntary deferral plan for an employee of a New York subsidiary could be terminated without requiring termination of the voluntary deferral plans for employees of a California subsidiary for which the New York employee would not have been eligible.
- A 10% employer contribution SERP for junior level VPs could be terminated without terminating the 25% employer contribution SERP for senior VPs.

Of, course, the participant whose plan is terminated could not then participate in a plan of the same Section 409A type offered by the employer, including its controlled group members. This would accomplish the policy goal of prohibiting acceleration without requiring drastic retooling of a service recipient’s deferred compensation program.

**IRS Response:** The Service representative disagrees with the proposed response. It would be necessary to terminate all plans of the same type for all members of all controlled groups. Even though they might seemingly be unrelated and might be unrelated lines of business, the concern is that this type of termination could be an end-around the acceleration rules under Section 409A.

### **13. § 415(c) – Failure to Limit Employer Contributions**

A multiemployer profit-sharing plan permits some non-bargaining unit employees (managers, owners, officers) to participate in the Plan pursuant to a written agreement. Participation by this group of employees is limited to those employees performing some bargaining unit work as set forth in applicable collective bargaining agreements (for example, an owner of a small company who is a former bargaining unit employee has some management duties but still performs bargaining unit work). A condition for participation in the plan for this group of employees is that the employer make monthly contributions (*i.e.*, nonelective employer contributions) to the plan on the employees' behalf based on a formula which is the *greater* of: (a) 160 hours per month multiplied by the employer contribution rate set forth in the applicable collective bargaining agreement, or (b) the number of hours the employee actually performed bargaining unit work.

When testing contributing employers, the Plan has found that employer contributions made to the profit-sharing plan on behalf of a few of these non-bargaining unit employees exceed 100 percent of the employees' compensation for a plan year and thus violate 415(c). In "Fixing Common Plan Mistakes – Failure to Limit Contributions for a Participant" (last updated 8/3/2012) the Service appears to address the issue by requiring forfeiture of employer contributions in excess of the 415(c) limitation but then provides that the "*plan sponsor* should transfer the forfeited employer contributions . . . to an unallocated account. These amounts are used to reduce employer contributions in the current year and, if applicable, subsequent year(s)." *See also*, Rev. Proc. 2013-12, Section 6.06(2).

For multiemployer plans, the plan sponsor is not a contributing employer but typically the plan's board of trustees. Rather than applying these forfeitures to *reduce* one employer's contribution obligation to the plan, which would violate the terms of participation between that employer and the plan, can the trustees apply forfeited employer contributions to the accounts of *all other* plan participants in a non-discriminatory manner as described in Treas. Reg. § 1.415-6(b)(6)(i) (as it appeared in the April 1, 2007 edition of 26 CFR part 1).

**Proposed Response:** Yes.

For limitation years beginning on or after January 1, 2009, Rev. Proc. 2013-12 provides that the failure to limit annual additions allocated to participants in a defined contribution plan as required in § 415 should be corrected in accordance with Section 6.06(2) of Rev. Proc. 2013-12, which provides in relevant part that any "nonelective employer contribution (adjusted for Earnings) which constitutes an Excess Allocation is . . . forfeited and placed in an unallocated account established for the purpose of holding Excess Allocations to be used to reduce employer contributions in the current year or succeeding year. . . While such amounts remain in the unallocated account, the employer is not permitted to make contributions (other than elective deferrals) to the plan."

As a practical matter, it would be administratively onerous to require a multiemployer plan to establish unallocated accounts for every contributing employer that has made nonelective employer contributions which constitute Excess Allocations for those employers. Moreover, by prohibiting an employer from making contributions to the plan while amounts remain in these unallocated employer accounts would be to permit an employer to avoid its obligations under the terms of the



employer's written agreement with the plan sponsor. Accordingly, the correction method described in 6.06(2) of Rev. Proc. 2013-12, at least in the context of multiemployer profit-sharing plans, should be understood to provide for the correction method described in Treas. Reg. § 1.415-6(b)(6)(i) (as it appeared in the April 1, 2007 edition of 26 CFR part 1):

The excess amounts in the participant's account must be allocated and reallocated to other participants in the plan. However, if the allocation or reallocation of the excess amounts . . . causes the limitations of section 415 to be exceeded with respect to each plan participant for the limitation year, then these amounts must be held unallocated in a suspense account. If a suspense account is in existence at any time during a particular limitation year, other than the limitation year described in the preceding sentence, all amounts in the suspense account must be allocated and reallocated to participants' accounts (subject to the limitations of section 415) before any employer contributions or employee contributions which would constitute annual additions may be made to the plan for that limitation year.

**IRS Response:** Based on the facts presented, the proposed correction method seems reasonable, although not necessarily for the reasons presented in the proposed response. The Service representative noted that given the peculiarities of multiemployer plans, the standard approach in the Revenue Procedure does not necessarily fit multiemployer plans. The Service representative also noted that if scenario were submitted using VCP, the Service would need some additional information about plan governance and plan administration.

#### **14. § 457A – Plan in Jurisdiction with Comprehensive Foreign Income Tax**

Assume that as of January 1, 2009, a foreign nonqualified entity, as defined in Notice 2009-8, sponsors a nonqualified deferred compensation plan that is subject to Code Sections 409A and 457A. In 2010, the entity reincorporated in a country with a comprehensive income tax and substantially all of its income becomes subject to the comprehensive foreign income tax from that date forward. Does the plan remain subject to Section 457A after the entity becomes subject to the comprehensive foreign income tax?

**Proposed Response:** No. The employer ceases to be a nonqualified entity as of the date that it reincorporates in the other country and becomes subject to a comprehensive income tax. Under Notice 2009-8, Q&A – 14, the determination of whether a nonqualified deferred compensation plan is a plan of a nonqualified entity is determined as of the last day of the service provider's relevant taxable year. Because the employer was no longer a nonqualified entity on December 31, 2010, the plan is not the plan of a nonqualified entity for 2010 and subsequent years and therefore is no longer subject to Section 457A.

**IRS Response:** The Service representative agrees with the proposed response and noted that the same applies in reverse. That is, if an entity moves from a comprehensive foreign income tax jurisdiction to a non-comprehensive foreign tax jurisdiction then the employer would be subject to Section 457A at the time it moves to the jurisdiction with the non-comprehensive foreign income tax structure.

#### **15. § 457A – Separate Plans under Section 409A**

An employer maintains a nonqualified deferred compensation plan for U.S. employees, and a foreign affiliate of the employer, which is a nonqualified entity (as defined in Notice 2009-8), maintains a non-qualified deferred compensation plan for its employees that is subject to both

Sections 409A and 457A. The participants in the nonqualified entity's plan are mainly nonresident aliens for U.S. tax purposes and do not participate in the plan for U.S. employees. Are both of these plans treated as the same "plan" under the Section 409A aggregation rules?

**Proposed Response:** No. Under Treas. Reg. § 1.409A-1(c)(2)(i)(G), one "bucket" of programs that are subject to 409A aggregation include "all deferrals of compensation with respect to that service provider under all agreements, methods, programs, or other arrangements of the service recipient to the extent the deferrals under the agreements, methods, programs, or other arrangements are deferrals of amounts that would be ... foreign earned income as defined under section 911(b)(1) ... if paid to the service provider at the time the amount is first deferred, and provided further that substantially all the participants in such agreements, methods, programs, or other arrangements and any substantially similar agreements, methods, programs, or other arrangements are nonresident aliens and that the service provider does not participate in a substantially identical agreement, method, program, or other arrangement that does not meet the requirements of this paragraph (c)(2)(i)(G) (a domestic arrangement)." The plan for U.S. based employees clearly does not fall within the "bucket" described in the regulation. The plan for the employees of the nonqualified entity fits within the regulation, and therefore is treated as a separate "plan" from the plan for U.S. employees under the aggregation rules.

**IRS Response:** The Service representative agrees with the proposed response. The regulations address this issue. The Service representative noted that the standard is that substantially all of the participants of the nonqualified entity's plan must be non-resident aliens in order for them not to be considered in conjunction with the Section 409A plan for purposes of the application of Section 409A.

#### **16. § 457(b) – Correcting Common Errors in Tax-Exempt 457(b) Plans**

A tax-exempt employer sponsors a 457(b) plan for its key executives and determines that the plan has been operated incorrectly since its inception based on either misunderstanding of the differences between a governmental and a tax exempt 457(b) plan or based on having received inaccurate advice from advisors.

#### **Question A – Correction of Erroneous Catch-up Contributions**

The 457(b) plan of a non-governmental tax exempt employer incorrectly allowed participating key executives over age 50 to make catch up contributions to the plan with the result that the plan contributions each year exceeded the allowable deferral under Code §457(c). The error was discovered after the allowable correction date of April 15 of the year following the year that the excess deferrals were made as required by Treas. Reg. 1.457-4(e)(3). Can the plan correct this error by (i) refunding of the "catch-up" contributions (adjusted for allocable income or losses) or (ii) retaining the plan's eligible status for contributions within the permitted Section 457(b) limits and treating the excess deferrals as a separate ineligible Section 457(f) plan?

**Proposed Response to Question A:** The proposed correction would not be allowable outside of a submission under EPCRS (Rev. Proc. 2013-12). The Service would accept a VCP filing in this situation. A VCP filing proposing either of these corrections under EPCRS would be accepted and approved to avoid the severe unintended taxation impact on the affected participants provided the employer demonstrates that the error was an unintentional result of either relying on inaccurate advice or misunderstanding of the applicable rules. The proposed correction provides a reasonable, measured correction method to an inadvertent mistake.

### **Question B – Insignificant Excess Deferrals to Tax-Exempt 457(b) Plan**

A non-governmental tax exempt employer miscalculated the amount of deferral allowed to the 457(b) plan and credited small insignificant amounts to participants for some years that exceeded the allowable deferral limitation of Code §457(c). The error was discovered after the allowable correction date of April 15 of the year following the year that the excess deferrals were made as required by Treas. Reg. 1.457-4(e)(3). Can the plan correct this error by (i) refunding of the “catch-up” contributions (adjusted for allocable income or losses) or (ii) retaining the plan’s eligible status for contributions within the permitted Section 457(b) limits and treating the excess deferrals as a separate ineligible Section 457(f) plan?

**Proposed Response to Question B:** The proposed correction would not be allowable outside of a submission under EPCRS (Rev. Proc. 2013-12). The Service would accept a VCP filing in this situation. A VCP filing proposing either of these corrections under EPCRS would be accepted and approved to avoid the severe unintended taxation impact on the affected participants provided the employer demonstrates that the error was an unintentional result of either relying on inaccurate advice or misunderstanding of the applicable rules. The proposed correction provides a reasonable, measured correction method to an inadvertent mistake.

### **Question C – Significant Excess Deferrals to Tax-Exempt 457(b) Plan**

A non-governmental tax exempt employer misunderstood the allowable deferral limitation of Code §457(c) believing that the 457(c) limitation applied to employee deferrals and that employer nonelective deferrals could exceed that limitation so long as the restrictions of Code §415 were satisfied. The employer’s misunderstanding was based either on the employer’s misperception or on incorrect information received from advisors. The deferrals credited to covered participants significantly exceeded the allowable deferral limitation of Code §457(c). Can the plan correct this error by (i) refunding of the “catch-up” contributions (adjusted for allocable income or losses) or (ii) retaining the plan’s eligible status for contributions within the permitted Section 457(b) limits and treating the excess deferrals as a separate ineligible Section 457(f) plan?

**Proposed Response to Question C:** The proposed correction would not be allowable outside of a submission under EPCRS (Rev. Proc. 2013-12). The Service would accept a VCP filing in this situation. A VCP filing proposing either of these corrections under EPCRS would be accepted and approved to avoid the severe unintended taxation impact on the affected participants provided the employer demonstrates that the error was an unintentional result of either relying on inaccurate advice or misunderstanding of the applicable rules. The proposed correction provides a reasonable, measured correction method to an inadvertent mistake.

### **Question D – Tax-Exempt 457(b) Plan Contributions Deposited into Trust**

A non-governmental tax exempt employer, in reliance on advice from the vendor third party administrator for its 457(b) plan, established a trust to hold the benefits accrued under the plan. All contributions were deposited annually to the irrevocable trust for the exclusive benefit of plan participants in violation of Treas. Reg. §1.457-8(b). The vendor erroneously believed that the tax exempt employer was a governmental employer and the employer was unaware that the trust was not permitted for a plan of a tax exempt non-governmental employer. Can the plan correct the impermissible contributions to the trust and retain its eligible status under 457(b) by dissolving the trust and returning the plan assets to the sponsor’s general assets subject to general creditor claims?

**Proposed Response to Question D:** The proposed correction would not be allowable outside of a submission under EPCRS (Rev. Proc. 2013-12). The Service would accept a VCP filing in this situation. A filing proposing this correction under EPCRS would be accepted and approved to avoid the severe unintended taxation impact on the affected participants provided the employer demonstrates that the error was an unintentional result of either relying on inaccurate advice or misunderstanding of the applicable rules. The proposed correction provides a reasonable, measured correction method to an inadvertent mistake.

**IRS Response:** This is a plan of a non-governmental tax exempt employer. The answer is driven by Section 4.09 of Revenue Procedure 2012-13 which provides that “submissions relating to § 457(b) will be accepted by the Service on a provisional basis outside of EPCRS... The availability of correction is generally limited to plans that are sponsored by governmental entities described in § 457(e)(1)(A).” The Service representative stated that there might be a way to handle this situation outside of EPCRS, such as a closing agreement or a special arrangement. The Service representative stated that he would not submit the plan under Revenue Procedure 2012-13.

#### **17. § 162(m) – Performance Pay**

May a company impose additional predetermined conditions on the receipt of qualified performance-based compensation where the additional conditions are not preestablished objective performance goals that have been approved by shareholders?

*Example:* No later than 90 days after the start of a fiscal year, but while the outcome is substantially uncertain, Corporation S establishes a bonus plan under which A, the chief executive officer, will receive a cash bonus equal to a percentage of Corporation S’s total profits for the fiscal year. The performance goal of profitability has been disclosed to and subsequently approved by the shareholders of Corporation S. In the event the performance goal is met, the compensation committee will reduce such cash bonus by up to 20% if the chief executive officer fails to meet other performance criteria set forth by the committee. These additional criteria have not been approved by shareholders. The committee is not permitted to increase the cash bonus under any circumstance.

**Proposed Response:** Yes. Treas. Reg. Section 1.162-27(e)(2)(i) provides that qualified performance-based compensation must be paid solely on account of the attainment of one or more preestablished, objective performance goals. Treas. Reg. Section 1.162-27(e)(4)(i) requires that the material terms of the performance goal under which the compensation is to be paid must be disclosed to and subsequently approved by the shareholders of the publicly held corporation before the compensation is paid. The material terms include the employees eligible to receive compensation; a description of the business criteria on which the performance goal is based; and either the maximum amount of compensation that could be paid to any employee or the formula used to calculate the amount of compensation to be paid to the employee if the performance goal is attained (except that, in the case of a formula based, in whole or in part, on a percentage of salary or base pay, the maximum dollar amount of compensation that could be paid to the employee must be disclosed). Treas. Reg. Section 1.162-27(e)(2)(iii) provides that the terms of an objective formula or standard must preclude discretion to increase the amount of compensation payable that would otherwise be due upon attainment of the goal, but that a performance goal is not discretionary merely because the compensation committee reduces or eliminates the compensation or other economic benefit that was due upon attainment of the goal.

Accordingly, the Company may condition receipt of qualified performance based compensation on the satisfaction of additional conditions, even if such conditions have not previously been disclosed

to and approved by shareholders, so long as the attainment of the preestablished, objective performance goal is necessary for entitlement to the compensation and the preestablished, objective performance goal has been disclosed to and approved by shareholders. The Company may require that any such bonus be reduced or eliminated as a result of a failure to satisfy additional conditions, even if such conditions have not been disclosed to and approved by shareholders and even if the reduction or elimination of compensation is not discretionary.

**IRS Response:** The Service representative agrees with the proposed response. Provided that all the other conditions have met the shareholder approval requirements, the addition of additional conditions to the type of compensation for it to be received by the individual would not cause it to fail Section 162(m).

#### **18. § 409A – Severance**

An employer (a service recipient) has a severance plan that provides the employer will pay an employee (a service recipient) severance if the employee voluntarily or involuntarily terminates employment (with a lesser amount for voluntary termination). The severance plan requires an employee provide 60-days notice of an intention to voluntarily terminate employment. The severance plan also provides that the employer may pay the employee wages for those 60 days in lieu of the employee actually performing services. The employer treats this 60-day period as paid leave. Assume an employee voluntarily terminates and receives a severance payment that is subject to Section 409A of the Code. When is the employee considered to have had a separation from service for purposes of Section 409A – on the last day the employee performs services or on the last day of the paid leave? Does the answer change if the employee works the first 30 days during the 60-day period and uses vacation for the final 30 days of the 60-day period?

**Proposed Response:** If the employer places the employee on paid leave, the employee does not have a separation from service until the end of the 60-day period. The answer does not change if the employee works for 30 days and then takes vacation to cover the remaining 30 days.

**IRS Response:** The Service representative disagrees with the proposed response. Under the facts presented, the employee does not appear to have the right to continued employment, and there is no reasonable expectation that the employee will return to employment. Based on the facts presented, the Service representative stated that there appears to have been a separation from service.

#### **19. 409A – Severance and the Short-Term Deferral Rule**

An employment agreement for a public company specified employee contains a safe harbor or satisfactory facts and circumstances definition of Good Reason. It provides severance on termination without cause or resignation for Good Reason. An amount equal to monthly salary will be paid monthly over 36 months on a separation from service for termination without cause or resignation for Good Reason. No severance is due on termination for disability. The agreement contains the 409A six month delay rule, where delay is required, and also states that each payment will be treated as a separate payment. The company has a calendar year fiscal year. IRS speakers have consistently stated that determining what is subject to the six-month delay requires first determining what is subject to the short term deferral rule (all of which is excluded from the six month delay), then what is subject to the 2X/2Y rule under Treas. Reg. Section 1.409A-1(b)(9)(iii), and only then applying the six month delay to what is left.

**First Scenario:** Assume the employee is fired on January 15, 2013. What is the short term deferral period for purposes of determining the first cut at 409A exemption?

**Proposed Response to First Scenario:** Payments actually made on or before March 15, 2014 will be exempt from the six month delay as short-term deferral payments, because the compensation vests on the termination date and March 15, 2014 is the end of the two-and-a-half month period after the year in which the compensation vests. Any of the payments due and made between January 15, 2013 and March 15, 2014 will be exempt.

**Second Scenario:** Assume the employee is fired on December 31, 2013.

**Proposed Response to Second Scenario:** Same answer, but the total short term deferral period is from December 31, 2013 through March 15, 2014.

**Third Scenario:** Assume the employee is fired on July 1, 2013, and the company has a June 30 fiscal year rather than a calendar year fiscal year.

**Proposed Response to Third Scenario:** The short term deferral would run through September 15, 2014, because it would end at two and a half months after the later to end of the calendar or fiscal year in which the termination occurs.

**Comment:** We strongly encourage the IRS to speak to this issue here or in some more formal way, because the proposed responses are exactly what we have heard in speeches and in informal conversations with IRS and Treasury, but there seems to be some lingering questions in the legal community about the short-term deferral period relative to severance.

**IRS Response:** The Service representative agrees with the proposed responses provided that the individual was actually subject to a substantial risk of forfeiture up until the time that the individual separated from service.

## **20. § 411(d)(6) – Change in Loan Duration**

An ESOP with a plan provision that limits the term of a loan to ten years enters into an exempt loan with a term of 20 years. The inconsistency is not discovered until the loan has been amortized for five years. In order to receive an allocation, a participant must be credited with 500 hours of service and be employed on the last day of the plan year. Can the plan be amended prospectively to increase the term of the loan to 20 years?

**Proposed Response:** Yes, but the plan sponsor will also need to make an additional payment or payments to the ESOP so that the shares that would have been allocated had the loan been for a ten-year term rather than a twenty-year term are allocated to participants who satisfied the requirements for years one through five. Because of the last day and hour of service requirement, there is no Code Section 411(d)(6) cutback by virtue of this amendment prospectively. Also, under these circumstances, the ESOP regulatory requirement that loans be amortized over one of two schedules should not be regarded as violated.

**IRS Response:** The Service representative indicated that they were not able to gather a consensus to respond to this question, but noted that if this question is submitted again next year, they will likely be able to respond.

## **21. § 6057 – Form 8955-SSA Reporting**

May a cash balance plan report a participant's account balance at termination as the vested benefit for purposes of Form 8955-SSA (and the related participant statement)?

**Proposed Response:** Yes. Applicable regulations indicate that “the form of benefit reported on Schedule SSA shall be the normal form of benefit under the plan or, if the plan administrator (within the meaning of section 414(g)) considers it more appropriate, any other form of benefit.” See IRS Reg. § 301.6057-1(a)(4).

Following the approach typically used for conventional defined benefit plans, that is, reporting the monthly annuity commencing at normal retirement age, does not seem appropriate with respect to cash balance plans, particularly where the interest crediting rate is variable. Such an approach would require the plan administrator to project the account balance through normal retirement age using an assumed rate of interest credit growth and converting that to a monthly annuity. However, this approach will almost certainly be confusing and/or potentially misleading from the participants’ point of view. For example, if the estimate of future interest credits turns out to be too high, the annuity reported to the IRS and to the participant will have been overstated.

The cited regulation clearly allows for alternative reporting where appropriate. For a cash balance plan, it seems appropriate to report a participant’s account balance at termination.

**IRS Response:** The Service representative agrees with the proposed response, but provided some additional reasoning. Under Section 301.6057.1(a)(4), a description of the nature, form and the amount of the deferred vested retirement benefit is to be reported on Form 8955-SSA. Under the regulations, the form to be reported is the normal form of benefit or any other form that is considered more appropriate. Under a cash balance plan, the Service representative agreed that it is appropriate to report on Form 8955-SSA the participant’s accumulated benefit in the form of a lump sum calculated as the participant’s hypothetical account balance.

The Service representative noted that the Form 8955-SSA is a bit hard to figure out since the questions are not designed around a cash balance plan. The Service representative stated that if he were filling out the form, he would use Code A and enter a single sum in column 9(d). In column 9(e), Code A could be entered again for a lump sum. In column 9(f), the participant’s hypothetical account balance could be entered.

The Service representative wanted to point out that the regulation refers to the normal form of benefit. Typically, the Service thinks that the normal form of benefit is the benefit from which other forms of benefit are calculated or derived, which is different from the default form of benefit. For example, in a defined benefit plan the default form of benefit might be a qualified joint and survivor annuity, but the normal form of benefit could be a single life annuity and the qualified joint and survivor annuity is derived from that calculation of the single life annuity. In that case, the normal form of benefit would be the single life annuity, whereas the default form of benefit is the qualified joint and survivor annuity.

## **22. § 401(a)(9) – Actuarial Adjustment of Cash Balance Benefit**

Plan A is a statutory hybrid plan under which a portion of the accrued benefit is defined as a hypothetical account balance. Plan A credits principal and interest at a rate that satisfies the final and proposed statutory hybrid plan regulations. Plan A provides a suspension of benefits notice to participants who remain employed following normal retirement age.

**Question A:** If Plan A provides a suspension of benefits notice at normal retirement age, does Plan A have to provide the required actuarial increases under Code Section 401(a)(9)(C)(iii) to the hypothetical account balance after a participant reaches age 70½?

**Proposed Response A:** Yes. Code Section 401(a)(9)(C)(iii) requires the hypothetical account balance to be actuarially increased to take into account the period after age 70½ in which the employee was not receiving any benefits under Plan A.

**IRS Response:** The Service representative agrees with the proposed response, but wanted to provide some clarification. The Service representative agrees that the plan must provide the required actuarial increase at age 70½, but noted that this requirement applies with respect to the accrued benefit rather than the balance of the hypothetical account. The Service representative also noted that the proposed regulations issued under Section 1.411(b)(5)-1(e)(4) provides an exception from the market rate of return requirement so that a plan can provide an actuarial adjustment that could be greater than a market rate of return without violating the market rate of return requirement. There is recognition that there is at least some possibility that the actuarial increase could be greater than the market rate of return and that is not going to be a violation of the market rate of return requirement.

**Question B:** Assuming an actuarial increase is required under Question A, if Plan A's post-normal retirement age principal and interest credits are equal to or greater than the required actuarial increase, is Plan A required to actuarially increase the hypothetical account balance under Code Section 401(a)(9)(C)(iii) above the amount of the principal and interest credits?

**Proposed Response B:** No. If the post-normal retirement age principal and interest credits equal or exceed any required actuarial increase under Code Section 401(a)(9)(C)(iii), then no actuarial increase of the hypothetical account balance is required in addition to the principal and interest credits.

**IRS Response:** Section 1.401(a)(9)-6, Q&A 8 provides that the retirement benefits payable with respect to an employee at the end of the period for actuarial increases must be no less than the actuarial equivalent of the employee's retirement benefit that would have been payable as of the date the actuarial increase must commence, plus the actuarial equivalent of any additional benefits and reduced by the actuarial equivalent of any distribution.

For this purpose, actuarial equivalence is determined using actuarial equivalence under the plan for purposes of satisfying Section 411. The Service representative noted that if interest credits are sufficient to constitute reasonable actuarial adjustments, then no additional adjustment is required. The interest credits can count against the actuarial increase requirement, but the interest credits do not necessarily satisfy the actuarial increase requirement. Pay credits cannot be counted toward satisfying the actuarial increase requirement unless the plan provides that the actuarial adjustment offsets additional accruals pursuant to Treasury Regulation Section 1.411(b)-2(b)(4)(i)(iii) of the proposed regulations. In other words, the pay credits and the interest credits can count against the required actuarial increase, but if they are insufficient to satisfy the actuarial increase, additional benefits would need to be provided and this would not be a violation of the market rate of return requirements.