Pension ANALYST

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PRUDENTIAL RETIREMENT

Year-End Developments Affect Qualified Plans

WHO'S AFFECTED These developments affect sponsors of and participants in qualified defined benefit and defined contribution plans.

BACKGROUND AND SUMMARY As the year 2000 came to a close, both Congress and the regulatory agencies in Washington, D.C., made changes to various rules relating to qualified plans. Some of these changes affect all plans:

- The “Consolidated Appropriations Act, 2001,” revised the definitions of “compensation” used for determining qualified plan contribution and benefit limits, identifying highly compensated employees (HCEs) and key employees, and performing nondiscrimination testing.
- Final IRS rules relating to tax withholding from certain qualified plan payments made to nonresident aliens took effect January 1, 2001.
- The Department of Labor (DOL) issued final rules regarding the required contents of Summary Plan Descriptions (SPDs).

Other changes affect only certain types of plans:

- IRS Notice 2001-9 provided that nonelecting church plans do not have to comply with certain IRS Tax Reform Act of 1986 (TRA’86) nondiscrimination regulations until the first day of the first plan year beginning on or after January 1, 2002.
- The Pension Benefit Guaranty Corporation (PBGC) issued a simplified premium form, Premium Form 1-EZ, to be used by certain single-employer defined benefit plans beginning in 2001.
- For plan years beginning after December 31, 2000, several new PBGC premium payment rules apply to defined benefit plans.
- The “Consolidated Appropriations Act, 2001,” increased the PBGC maximum benefit plan guarantee for workers covered by defined benefit multiemployer pension plans to $12,870.

ACTION AND NEXT STEPS Plan sponsors should review the changes described in this publication and identify those that affect their plans. If you have questions regarding the effect of these changes on your plan document or its operation, please contact your Prudential Retirement Representative.

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Changes Affecting All Qualified Plans

Compensation Definitions

The "Consolidated Appropriations Act, 2001," revised the definitions of compensation used for determining qualified plan contribution and benefit limits, identifying highly compensated employees (HCEs) and key employees, and performing nondiscrimination testing.

Under the new law, salary reductions for qualified transportation fringe benefits (employer-provided transit passes, vanpooling, and qualified parking) are treated just like §125 cafeteria plan salary reductions. These amounts are now included in participants' "Section 415 compensation." Section 415 compensation is the compensation used in determining the annual additions limits for participants in defined contribution plans and the comparable defined benefit plan benefit limits. This compensation is also used in calculating top-heavy minimum benefits and contributions, and identifying HCEs and key employees. In addition, this definition of compensation may be used "as is" for nondiscrimination testing (e.g., ADP and ACP tests), or may be modified to exclude these types of salary reductions.

These changes are effective for years beginning after December 31, 1997. Given this retroactive effective date, we expect the IRS will publish some transition guidance. We will keep you posted regarding any such developments.

Nonresident Alien Federal Tax Withholding

Final IRS rules relating to tax withholding from certain qualified plan payments made to nonresident aliens took effect January 1, 2001. These new rules only affect payments that are subject to tax treaties.

In general, payments made to nonresident aliens are subject to 30% federal income tax withholding. This standard treatment does not apply if a payee provides documentation certifying to the portions of the payment that are entitled to different treatment. One exception to 30% withholding is for payments that are subject to a tax treaty between the U.S. and the payee's home country. Under the old rules, a payee could claim the tax treaty exception by simply submitting a completed IRS Form 1001. Form 1001 did not require a Social Security Number (SSN) or an Individual Taxpayer Identification Number (ITIN).

Effective for payments made on and after January 1, 2001, Form 1001 is obsolete. Instead, IRS Form W-8BEN is now required. Form W-8BEN requires the payee to have a valid U.S. SSN or ITIN to claim the tax treaty exception. If a properly completed Form W-8BEN is not submitted with the nonresident alien's request for payment, the payor must withhold 30% of that payment for federal income taxes. The payor cannot refund the taxes withheld if Form W-8BEN is submitted after the payment has been made.

A nonresident alien who wishes to claim tax treaty treatment but does not have a valid U.S. SSN must file a Form W-7 with the IRS to obtain an ITIN. Once the ITIN is issued, the payee must submit a Form W-8BEN to the payor with the ITIN indicated in box #6.

SPD Content Rules

The Department of Labor (DOL) has issued final rules regarding the required contents of Summary Plan Descriptions (SPDs). These rules are effective the first day of the second plan year beginning on or after January 22, 2001 (e.g., January 1, 2003, for a calendar plan year; but July 1, 2002, if the plan year begins July 1).

Under the new rules:

- Acceptable plan descriptions now include: "ERISA section 404(c) plan," "defined contribution plan," "401(k) plan," and "cash balance plan."
- The SPD must include either a description of the plan's procedures governing qualified domestic relations order (QDRO) determinations, or a statement indicating that participants and beneficiaries can obtain, without charge, a copy of these procedures.
- Additional plan termination information must be provided.
- Separate model statements regarding PBGC coverage are provided for single-employer and multiemployer defined benefit plans.
- Revisions have been made to the standard "Statement of ERISA Rights."

Changes Affecting Nonelecting Church Plans

A "church plan" is a plan established and maintained for its employees by a church or by a convention or association of churches that is exempt from federal income tax under Internal Revenue Code section 501. A "nonelecting church plan" is a church plan that has not made a formal election to be subject to ERISA minimum participation, vesting, and funding rules.

IRS Notice 2001-9 provides that nonelecting church plans do not have to comply with the IRS Tax Reform Act of 1986 (TRA'86) regulations relating to:

- General nondiscrimination rules (Code sections 401(a)(4) and 401(a)(5));
- Permitted disparity ("integration") rules (Code section 401(l)); and
- The nondiscriminatory definition of compensation (Code section 414(s))

until the first day of the *first plan year beginning on or after January 1, 2002*. Previously, IRS Notice 98-39 required these plans to comply with these rules as of the first day of the first plan year beginning on or after January 1, 2001.

For plan years beginning before January 1, 2002, sponsors of nonelecting church plans must operate their plans in accordance with a reasonable, good faith interpretation of these rules.

Notice 2001-9 does not change the deadline for amending nonelecting church plans to comply with these TRA'86 nondiscrimination rules.

The *amendment deadline is still the last day of the 2001 plan year*, which is also the deadline for making "GUST" amendments. Sponsors of nonelecting church plans had to adopt all other TRA'86 plan amendments (e.g., relating to section 401(k) and 401(m) rules) by the last day of the 1999 plan year.

Changes Affecting Defined Benefit Plans Only

PBGC Form 1-EZ

The Pension Benefit Guaranty Corporation (PBGC) has issued a simplified premium form, Premium Form 1-EZ. Beginning with the 2001 plan year, a single-employer plan that is exempt from the variable rate premium will use Form 1-EZ, instead of Form 1 and Schedule A, to make its final premium filing for the plan year.

A single-employer plan is exempt from the variable rate premium if it falls into one of the following categories:

- Plans with no vested participants.
- Plans funded exclusively by individual insurance contracts ("section 412(i) plans").
- Plans with fewer than 500 participants and no unfunded vested benefits.
- Plans that have issued notices of intent to terminate in a standard termination with a proposed termination date on or before the premium snapshot date.
- Plans at the full funding limit.

A single-employer plan that is not exempt from the variable rate premium but has a calculated variable rate premium of zero must continue to file Form 1 and Schedule A to make its final premium filing for the year. A multiemployer plan files Form 1 alone.

The PBGC intended to mail the Form 1-ES package to plan sponsors early in January and Form 1, Schedule A, and Form 1-EZ package in early February. The forms and instructions may also be downloaded from the PBGC Web site at http://www.pbgc.gov and filed with the PBGC.

Revised PBGC Premium Payment Rules

For plan years beginning after December 31, 2000, several new PBGC premium payment rules apply.

Short Plan Years. The plan administrator of a plan that has a short plan year now has the option of either

- Paying a full-year premium and then requesting a refund or claiming a credit against a future premium payment, or
- Paying a prorated premium.

This rule covers the following situations:

- A short first year of a new plan;
- A short year created by a change in plan year;
- A short year caused by the distribution of plan assets due to plan termination; or
- A short year caused by the appointment of a trustee for a single-employer plan under a PBGC initiated plan termination.

The plan administrator may anticipate that the plan will have a short plan year (e.g., pay-out of plan assets due to termination) and pay a prorated premium. However, if that plan year turns out to be longer than anticipated, the employer must make up any premium underpayment, including any required interest and penalties from the due date forward.

The risk of error in anticipating a short plan year is greater for plans with 500 or more participants, which pay flat rate premiums within two months of the start of the plan year (with Form 1-ES). If:

- The plan sponsor adopts an amendment changing the plan year before the Form 1-ES filing due date;
- The short plan year has not ended as of the Form 1-ES filing due date; and
- Later events result in a longer plan year than expected,

the penalty on the underpayment of the flat rate premium is waived.

The new rules clarify when a short plan year exists for PBGC premium payment purposes, if the plan is merged, consolidated or spun-off.

Definition of Participant. For PBGC premium payment purposes, individuals are classified as active, inactive and deceased participants. Under the new rules, an "active" participant is still defined as an individual who is earning or retaining credited service under the plan. However, an individual will no longer be considered an active participant if the plan does not have any benefit liability for him as of the premium snapshot date.

In addition, the PBGC has changed the rules for determining when a nonvested individual is no longer counted as a participant for premium purposes. Under the new rules, a non-vested individual is no longer considered to be a participant after:

- He incurs a one-year break-in-service, as defined in the plan; or
- His benefit is deemed to be cashed out under the terms of the plan; or
- He dies.

A vested individual is no longer considered to be a participant after all his benefit liabilities have been provided for, by either:

- Payment from the plan; or
- Purchase of an insurer's irrevocable commitment to provide the benefits.

Increased PBGC Multiemployer Plan Benefit Guarantee

The "Consolidated Appropriations Act, 2001," increases the PBGC maximum benefit plan guarantee for workers covered by insolvent multiemployer pension plans. This guarantee does not have an automatic cost-of-living adjustment and this is the first increase since 1980. For a worker with 30 years of service under this type of plan, the maximum annual guarantee increases from $5,850 to $12,870.

The increased guarantee limit applies to participants in any multiemployer plan that has not received PBGC financial assistance within a one-year period ending on December 21, 2000.