

IRS and DOL Provide Clarifying Guidance

WHO'S AFFECTED This guidance applies to most qualified defined benefit and defined contribution plans, including multiemployer plans. Some of this guidance (as indicated below) does not apply to governmental or non-electing church plans.

BACKGROUND AND SUMMARY In January, the IRS issued a number of pieces of guidance relating to the operation of qualified plans. This publication summarizes the following:

- Guidance on defined contribution plan expenses ([Revenue Ruling 2004-10](#)), which does *not* apply to governmental or non-electing church plans;
- Guidance on the special minimum coverage transition rule ([Revenue Ruling 2004-11](#)), which does *not* apply to governmental or non-electing church plans;
- Clarification on distributions from separate rollover accounts ([Revenue Ruling 2004-12](#));
- Special rules for safe-harbor plans that are exempt from top-heavy testing ([Revenue Ruling 2004-13](#)), which do *not* apply to governmental plans;
- Updated procedures for minimum funding standard waiver requests for defined benefit plans and defined contribution pension plans ([Revenue Procedure 2004-15](#)), which do *not* apply to governmental or non-electing church plans.

In addition, the Department of Labor (DOL) has released the [2003 Form 5500 and Instructions](#). Within the instructions, the DOL has added language requiring plan auditors to verify that the question of late participant contributions is being answered according to the regulations around participant contribution requirements. Governmental plans and non-electing church plans do not file Form 5500.

ACTION AND NEXT STEPS Plan sponsors should review the information in this publication to determine which items apply to their plans.

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*Republished December 2004 to reflect Prudential Financial's acquisition of CIGNA's retirement business.

IRS Guidance on Defined Contribution Expenses

In May 2003, the DOL published Field Assistance Bulletin (FAB) 2003-3, providing guidance for allocating plan expenses among participants in defined contribution plans. As explained in our publication titled "[DOL Provides Guidance on Defined Contribution Plan Expenses](#)," the DOL specifically approved the practice of charging vested separated participant accounts the account's share of plan expenses, on a pro-rata or per capita basis, even if active participant accounts are not charged those expenses. However, the DOL could not and did not rule on whether such a practice might be viewed as imposing a "significant detriment" on participants who did not take immediate distributions at separation from service. At that time, the DOL pointed to the IRS to provide guidance regarding this issue.

The IRS has now confirmed that, generally, a plan may charge reasonable plan expenses to the accounts of former employees and their beneficiaries, even if the plan does not charge the accounts of current employees. However, the IRS reminds plan sponsors that not every method of allocating plan expenses is reasonable in all situations. A method that is not reasonable for a specific situation could impose a significant detriment to participants.

In addition, the IRS reminds plan sponsors that the allocation of plan expenses must comply with nondiscriminatory availability of benefits, rights, and features rule. *For example, if a plan's method of allocating expenses is amended in anticipation of a divorce of a highly compensated employee, from being allocated solely to the participant's account to being allocated pro rata across all accounts, the timing of that plan amendment may fail to satisfy the nondiscriminatory availability requirement.*

IRS Guidance on Special Minimum Coverage Transition Rule

A special transition rule allows plans involved in company level merger and acquisition transactions to be treated as satisfying the minimum coverage requirements during a transition period following the transaction. The transition period begins on the date of the transaction and ends on the last day of the following plan year. This special transition rule can be used if a plan has satisfied the minimum coverage requirements immediately before the transaction, and if there have been no specific changes in the plan's coverage aside from the transaction.

The recent guidance from the IRS clarifies that this special transition rule applies solely for purposes of satisfying the minimum coverage requirements. It does not provide relief from satisfying ADP and ACP tests. In addition, if there is a significant change in a plan or in the coverage of a plan (other than the acquisition or disposition) during the transition period, the transition period is simply shortened. This type of change does not make the plan retroactively ineligible to apply the transition rule.

For example: Subsidiary S is part of the STU Group, a controlled group of corporations. S sponsors a defined benefit pension plan and a profit-sharing plan for its employees. Both plans have calendar plan years. On June 22, 2004, S is sold through a stock sale to the QRS Group. Immediately before the sale, S's defined benefit plan satisfies the minimum coverage requirements. S continues to maintain the defined benefit plan, but amends the plan to significantly change the benefit formula effective April 1, 2005. This plan amendment is a significant change in the plan.

The effect of the change is that the plan will be treated as satisfying the minimum coverage requirements during the transition period from June 22, 2004 through March 31, 2005. Beginning April 1, 2005, the defined benefit plan must satisfy the minimum coverage requirements. The defined benefit plan amendment does not reduce the profit sharing plan's transition period, because the plans separately satisfy coverage requirements. Therefore, the profit sharing plan is treated as satisfying the minimum coverage requirements through December 31, 2005, the last day of the 2005 plan year.

IRS Guidance on Distributions of Rollover Contributions

The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) expanded both the *types of plans* eligible to accept rollover contributions, and the *types of dollars* that can be rolled over.

The recent IRS guidance explains that if an eligible retirement plan separately accounts for amounts attributable to rollover contributions, distribution of those rollover amounts will not be subject to the timing restrictions that may apply to other contributions made to the plan. Therefore, a plan may allow rollover contributions to be distributed at any time pursuant to an individual's request. *For example, if the receiving plan is a money purchase pension plan that separately accounts for rollover contributions, the plan document may allow participants to take in-service withdrawals of their rollover dollars, even though participants cannot withdraw the standard money purchase plan contributions while they are active employees.*

However, the distribution of the rollover amounts is still subject to the receiving plan's survivor annuity requirements, minimum required distribution (MRD) rules, and 10% premature distribution penalty, if applicable.

IRS Guidance on Special Top-Heavy Rules for ADP Safe Harbor Plans

Some 401(k) plans do not have to perform ADP and ACP testing because they use the [ADP and ACP safe harbor designs](#). These plans are also exempt from top-heavy testing. This top-heavy exemption applies on a year-by-year basis, and only if the plan consists *solely* of a safe harbor 401(k) arrangement and any matching contributions under the plan meet the ACP safe harbor requirements. The IRS has now provided examples of when a safe harbor plan is considered to meet this requirement, and therefore is deemed to be not top-heavy. In all the situations described below, assume that the plan contains elective deferral contributions, safe harbor matching contributions, and permits discretionary nonelective employer contributions.

Situation 1: No discretionary nonelective contributions are made for plan year 2004. The only contributions made to the plan for the 2004 plan year are elective deferral contributions and safe harbor matching contributions. No forfeitures are reallocated to participants. This plan is deemed to be not top-heavy for 2004.

Situation 2: The employer makes a discretionary nonelective contribution for 2004. As a result, the plan does *not* meet the requirements for the top-heavy exemption, and *must perform the top-heavy test for 2004*.

Situation 3: The employer does not make a discretionary nonelective contribution for 2004, but forfeitures are reallocated to participants' accounts for 2004 in the same manner as nonelective

contributions. The plan does *not* meet the requirements for the top-heavy exemption and therefore *must perform the top-heavy test for 2004*.

Situation 4: Employees are permitted to make elective deferrals immediately, but must complete a year of service with the employer to be eligible for matching contributions. Since the employees with less than a year of service are not eligible for the safe harbor matching contributions, the plan as a whole does *not* meet the top-heavy exemption requirements. Therefore, the plan *must perform the top-heavy test for 2004*.

Updated Procedures for Minimum Funding Standard Waiver Requests

The IRS has updated the procedures for requesting a waiver of the minimum funding standard for defined benefit plans and defined contribution pension plans. The revised procedures include updated mailing addresses for submissions, as well as some additional information requirements.

Requests for waivers must now include information regarding executive compensation arrangements. This involves including detailed statements concerning all amounts that the entity has paid or will pay to each person who is an officer or director during the plan year for which the request is made and the 24 months that immediately precede that plan year. The revised procedures provide details on how to determine officers and directors for these purposes. They also include a comprehensive list of payments (such as salaries, non-qualified deferred compensation, insurance policies, etc.) to be included in the statement.

The revised procedures also include a submission checklist to ensure that all waiver request submissions are complete. This checklist must accompany the request for the waiver of the minimum funding standard.

The updated procedures are effective for all requests received after February 17, 2004. The entire revenue procedure is available at: <http://benefitslink.com/IRS/revproc2004-15.pdf>. Sponsors of defined benefit plans should enlist the help of the plan's enrolled actuary when making a request for a waiver of the minimum funding standard.

Changes to Form 5500 Instructions Regarding Late Participant Contributions

Late participant contributions have been a hot topic for the DOL in recent years. As such, the DOL has tried to clarify the Form 5500 instructions to explain when participant contributions are considered late and therefore must be reported on Form 5500.

On the 2003 Form 5500 Instructions, the DOL has added language requiring plan auditors to ensure that employers are appropriately responding to the question of late participant contributions on the Schedules H and I. These revised instructions require the auditor to verify that the information contained on these Schedules regarding late participant contributions is in accordance with the regulatory requirements, and to include this information in the auditor's report.

Next Steps

This recent guidance is simply informational. None of it requires changes to be made to plan documents, or to plan operations. However, some of it may open the door to new plan design possibilities or clarify the application of certain rules in specific situations.

Pension Analyst by Prudential Retirement

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