Pension ANALYST
COMPLIANCE BULLETIN

June 2000*

IRS Modifies "Same Desk Rule"

The IRS recently announced a change to the "same desk rule" in Revenue Ruling 2000–27. This change relaxes the requirements for distributing accounts from a 401(k) plan as a result of a sale of less than 85% of the assets of a trade or business to an unrelated employer.

401(k) Distribution Requirements

Distributions of 401(k) deferral contributions and related earnings may only be made when certain events occur. One of those events is a separation from service. However, to determine if a plan may make distributions due to a separation from service, the "same desk rule" must be considered. The same desk rule, simply stated, is that an employee doing the same work in the same location has not had a separation of service, even if there is a formal change of employer through dissolution, merger, acquisition, or similar transactions. Under this rule, an employee may only receive a distribution due to separation from service if the employee dies, retires, resigns or is discharged, and not if the employee continues on the same job for a different employer due to a liquidation, merger or consolidation of the former employer.

There are certain exceptions to the same desk rule. If the same desk rule applies (i.e., a separation from service did not occur) because of a merger or acquisition, 401(k) deferral contributions and related earnings may still be distributed to all affected former employees if the plan permits distributions when:

- A corporation sells its interest in a subsidiary to an unrelated entity through a stock sale ("sale of subsidiary"); or
- A corporation sells at least 85% of the assets used in a trade or business of the corporation to an unrelated corporation ("sale of assets").

To determine if a plan may make distributions as a result of a sale of assets, the following criteria must be met:

- Both the seller and the purchaser are corporations;
- The seller continues to maintain the plan after the sale;
- The seller and purchaser are not part of the same controlled group or affiliated service group;
- Employees receiving distributions continue employment with the purchaser; and

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

- The employee's entire account balance is distributed in a single lump sum by the last day of the second calendar year following the year of the corporate transaction.

Effect of Same Desk Rule

The same desk rule often creates problems for employers in merger and acquisition situations. In cases where a company is sold and the sale does not qualify as either a sale of assets or sale of subsidiary, but the same desk rule applies, employees are not allowed to receive complete distributions from the seller's 401(k) plan. These amounts must either be left in the former employer's plan, or be transferred to the new employer's plan. If left in the former employer's plan, that employer has to remain in contact with its former employees to determine when distributions eventually may be made. If transferred, the new employer's plan must protect certain benefits provided in the former employer's plan. Neither solution is ideal for the seller, the purchaser or the affected employees.

New Ruling

The new ruling relaxes the same desk rule and allows the distribution and rollover of 401(k) assets more often in merger and acquisition situations.

This ruling relaxes the same desk rule in the situation where a company sells less than 85% of the assets used in a trade or business to an unrelated employer. The purchaser does not maintain the seller's plan, and hires some of the employees of the seller on the date of the sale. These employees continue to perform the same duties for the new employer.

Prior to this ruling, the participants affected by this type of sale could not take distributions of their entire vested account balances. However, the IRS has now ruled that under these facts, the transfer of the employees to the purchasing company is considered a separation of service, regardless of whether the seller or buyer is a corporation, partnership, individual, or any other type of entity.

Consequently, plan assets may be distributed to affected participants. If permitted by the new employer's plan, these employees may roll over their distributions to that plan, thereby preserving their tax deferrals on these amounts while eliminating the need for the new employer's plan to protect special benefits provided by the old plan.

Keep in mind that this ruling applies only to situations matching the facts presented in the ruling. There may still be situations where assets cannot be distributed because the same desk rule applies.

For example:

- A corporation's sale of at least 85% of the assets used in a trade or business of the corporation to an unrelated partnership, individual or other non-corporate entity.

- A partnership or individual's sale of at least 85% of the assets used in one of its trades or businesses to a corporation, partnership, individual or other type of entity.

This modification of the same desk rule may be applied immediately, and must be applied for a sale of less than 85% of the assets used in a trade or business occurring on or after September 1, 2000. For a sale of less than 85% of the assets used in a trade or business that occurs before September 1, 2000, the seller may choose not to treat the change in employment to the purchaser as a separation of service. Note that this choice would prohibit distributions and would require plan-to-plan account transfers instead.

Prudential Financial is a service mark of The Prudential Insurance Company of America, Newark, NJ and its affiliates. The Pension Analyst is published by Prudential Retirement, a Prudential Financial business, to provide clients with up-to-date information on current legislation and regulatory developments affecting qualified retirement plans.