

QUALIFIED PLANS 2005-5

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1. DOL Regulatory Agenda

On May 16, the DOL's Employee Benefit Security Administration (EBSA) published its semiannual Regulatory Agenda. 70 Fed. Reg. 27,163. The Agenda sets out those initiatives upon which EBSA believes there is a realistic possibility of progress within the next 6 to 12 months. The agenda is an ambitious one announcing a number of significant new projects. The most significant proposals – many of which focus on disclosure of fees for services – are highlighted below.

Fee Disclosure Under the "Reasonable Services" Exemption – DOL has proposed to reopen its regulation under section 408(b)(2), the prohibited transaction exemption for the provision of services by a party in interest to a plan, "to eliminate uncertainty as to what information relating to services and fees plan fiduciaries must obtain and service providers must furnish for purposes of determining whether a contract for services to be rendered to a plan is reasonable." While DOL has for a number of years taken the position that, when selecting a service provider, a plan fiduciary has an obligation to understand the compensation received by the service provider "from all sources" to ensure

that the compensation paid to the service provider by the plan is reasonable, it has not articulated a specific obligation on the part of the service provider to disclose this fee information to the plan. DOL has received information suggesting that some service providers, including recordkeepers, have been unwilling to provide the information to plan fiduciaries who request it, and EBSA is looking for a way to motivate service providers to do so. Thus, disclosure of compensation received from all sources, including third parties, may become a condition of relief under section 408(b)(2). Pension plan service providers presumably need this relief because, while not fiduciaries, they are liable for excise taxes if they participate in non-exempt prohibited transactions, including the provision of services to plans.

Form 5500 – EBSA plans to amend the rules under section 104 of ERISA to require electronic filing, and will "amend and update" the regulatory requirements for the Form 5500 in conjunction with this proposal. (The last major revisions were in 1999.) We believe that, at a minimum, the DOL will be looking to revise or "clarify" the requirements for reporting under Schedule C, specifically relating to the reporting of compensation paid "indirectly" by the

plan (e.g., shareholder service fees received by plan recordkeepers).

Section 404(c) – DOL proposes to amend the section 404(c) regulation, which provides relief to fiduciaries of participant-directed plans, to ensure that participants receive the information necessary to make informed decisions about plan investments, particularly fee and expense information. We expect this review to include – if not focus primarily on – 12b-1 fees and other recordkeeper compensation paid indirectly through investment vehicles.

Participant Contribution "Safe Harbor" – Under the current regulations, participant contributions become "plan assets" (and are subject to the trust requirement and the prohibitions on an employer's "use") on the earliest date by which they can "reasonably be segregated" from the employer's general assets. DOL intends to propose an amendment to the regulation establishing a "safe harbor" period of a specific number of days (as yet undetermined) during which participant contributions will not be treated as "plan assets," whether or not they could have been reasonably segregated. Presumably, if an employer complies with the safe harbor, it will not have to make an individual determination regarding the "segregation" date.

Other Items – DOL also intends to finalize the new "abandoned plan" program (Qualified Plans 2005-3), and restate the Voluntary Fiduciary Compliance Program to include the recent amendments (Qualified Plans 2005-4). Lastly, Section 610 of the Regulatory Flexibility Act requires agencies to periodically review rules that have a significant economic impact on "small entities." In this regard, EBSA has identified for review its prohibited transaction exemptions procedures and the participant loan rules under the section 408(b)(1) regulations. Usually, these reviews are "pro forma," but both of these subjects are of particularly broad interest.

2. Next Round of Deferred Compensation Guidance Expected "Mid-Summer"

As the summer draws near, many are asking whether Treasury and the IRS will meet their goal for issuing the second round of guidance on Code section 409A. Ever since the issuance of Notice 2005-1 late last year (Qualified Plans 2004-12), Treasury and IRS officials have indicated that a second round of guidance will be issued by "mid-summer" 2005, but informal conversations with

Treasury and IRS officials indicate that the issuance may slip to late summer. If this is the case, it will leave very little time for plan sponsors to make plan design decisions and amend their nonqualified deferred compensation plans by December 31, 2005, the current deadline under Notice 2005-1 for complying with Code section 409A in form and operation.

In an effort to shape the second round of guidance, plan sponsors, trade associations, and professional organizations have submitted dozens of comments on significant issues in the application and interpretation of Code section 409A. The following is a brief summary of key areas Treasury and the IRS are likely to address in the second round of guidance.

- **Extend the December 31, 2005 Deadline** – A majority of the comments submitted have asked Treasury and the IRS to postpone the December 31, 2005 deadline for amending plans to comply with Code section 409A in form and operation to a much later date. Commenters have argued that reviewing, digesting, and actually implementing the requirements in the second round of guidance by the December 31, 2005 deadline will be virtually impossible, regardless of the date the guidance is actually issued. Public companies subject to SEC filing and shareholder approval requirements, of course, face additional major compliance tasks.
- **Severance Arrangements** – Several comments have requested that Treasury and the IRS make permanent the exception for broad-based severance arrangements under Q&A-19(d) of Notice 2005-1. That exception is now limited to the 2005 plan year. Many also have recommended that severance arrangements that satisfy the Department of Labor (DOL) safe harbor for severance pay plans (under 29 CFR § 2510.3-2(d)) or that pay out only upon an involuntary termination should be exempt from the requirements under Code section 409A, even if such plans cover "key employees."

- **Material Modifications to Grandfathered Amounts** – Notice 2005-1, Q&A-18(a), provides that a nonqualified deferred compensation arrangement is "materially modified" if a benefit or right existing as of October 3, 2004 is enhanced or a new benefit or right is added. If a nonqualified arrangement is materially modified, amounts deferred under the arrangement that were earned and vested before 2005 are subject to Code section 409A. The Notice provides limited guidance as to what is and is not a material modification. Commenters have requested that the upcoming regulations provide additional guidance and examples of what may or may not constitute a material modification for purposes of Code section 409A.
- **Identification of Key Employees** – Code section 409A(a)(2)(B)(i) provides that distributions made to a "key employee" (as defined under Code section 416(i)) of a publicly traded corporation upon the employee's separation from service may not be made for six months (or upon the earlier death of the employee). While it appears that this special rule contemplates the identification of a key employee at the time of distribution, the exact date to determine key employee status is unclear. Based primarily on recent changes in EGTRRA, comments have proposed that Treasury and the IRS adopt a look-back rule for identifying key employees and specify a fixed date on which to make the determination e.g., the last day of the prior plan year).
- **Stock Appreciation Rights ("SARs")** – Q&A 4(d) of Notice 2005-1 provides exceptions from section 409A for certain fair market value stock options and cash-settled SARs issued by public companies, as well as transition relief for certain other fair market value SARs that do not qualify for the exception. Commentators have asked for broader exceptions for stock options and SARs, along with suggestions to address the concerns of Treasury and IRS

regarding the valuation of private companies for these purposes.

While far from certain, Treasury and IRS officials appear to be open to many of the above recommendations, including some delay in the effective date for complying with the documentation requirements and possibly other aspects of Code section 409A. We will provide a detailed analysis of the second round of guidance as soon as it is issued.

3. Portman-Cardin Packages Reintroduced

On April 28, prior to officially becoming the U.S. Trade Representative, Congressman Rob Portman (R-OH) introduced the "Pension Preservation and Savings Expansion Act of 2005" (H.R. 1960). On the same day, Congressman Ben Cardin (D-MD), who recently announced a bid for the Senate, introduced substantially identical legislation with the same title (H.R. 1961). Each bill includes many of the pension reform proposals that they introduced last Congress (Qualified Plans 2003-7, 2003-4) as well as several new proposals.

Although the bills are substantially identical, two major differences stand out. First, Cong. Cardin's comprehensive pension reform package (but not Cong. Portman's) would repeal Roth 401(k) accounts, which are set to become effective for plan years beginning on or after January 1, 2006 (Qualified Plans 2005-3). Nevertheless, Cong. Cardin has informally indicated to several benefits groups that he does not intend to pursue repeal. Second, Cong. Portman's legislative package (but not Cong. Cardin's) includes a proposal for Retirement Savings Accounts ("RSAs"), a universal, Roth IRA-type retirement savings vehicle similar to the one first introduced in the Bush Administration 2003-2004 Budget.

Principal common elements in the two bills include the following –

- **Making EGTRRA Changes Permanent** – The reforms enacted under EGTRRA are scheduled to sunset at the end of 2010. Both bills would make the changes permanent.
- **Faster Vesting** – The faster vesting schedule for employer matching contributions enacted as part of EGTRRA (i.e., 3-year cliff or 2- to 6-year graded) would be extended to

other employer contributions (e.g., profit sharing plan contributions).

- **Exclusion for Lifetime Annuity Payments** – Plan participants receiving lifetime annuity payments would be able to exclude up to \$2,100 of the annuity payment from income each of the first 5 years of annuity payments.
- **Minimum Required Distributions** – The age 70-1/2 minimum distribution requirement would be indexed to future increases in life expectancy, individuals with less than \$100,000 in their combined IRA and 403(b) accounts would be exempt from the rules altogether, and the 50% penalty tax would be reduced to 25%.
- **"Enron-Driven" Reforms** – Plan participants with employer contributions in company stock under a 401(k) plan will be able to diversify their accounts, and penalties would be imposed on certain compensation paid to top executives within 2 years before or during bankruptcy.
- **"Auto Enrollment"** – A 401(k) plan providing for automatic enrollment (and automatic contribution increases) and meeting certain matching (or nonelective) contribution, participation, vesting, and notice requirements, would be eligible for a safe harbor from the ADP/ACP tests and top-heavy rules. The bills also include changes to ERISA to provide for section 404(c) safe harbor investments under, and preempt conflicting state laws with respect to, "automatic contribution arrangements."

Although many in the pension community are generally pleased to see that these proposals are still "on the table," the entire pension legislation "pot" is in a state of tremendous flux. Issues such as DB funding reforms and cash balance plans are on the table, and pension changes generally may even become enmeshed in the massive Social Security debate, particularly in the House. In light of this, and the effective absence of Congressmen Cardin and Portman, the latest Portman-Cardin proposals have an especially long way to go in the legislative process.

4. SEC Report Card on Pension Consultants Exam "Sweep"

On May 16, the Securities and Exchange Commission ("SEC") Office of Compliance Inspections and Examinations released its much-anticipated report on the examination sweep of the practices of pension consultants registered with the SEC as investment advisers under the Investment Advisers Act of 1940 ("Advisers Act"). (The report is available on the SEC's website at www.sec.gov.) Overall, the report does not reflect well on the pension consulting industry – finding that many consultants receive undisclosed or inadequately disclosed compensation from money managers that provide services to the consultants' plan clients, and do not adequately identify and work to mitigate their conflicts of interest.

The SEC staff reviewed practices of 24 pension consultants, selected from more than 1700 investment advisers registered with the SEC that have reported providing pension plan consulting services. The examination included (a) a review of products and services offered to plans, money managers and mutual funds, (b) how consultants are paid for services, and (c) the disclosure provided to the consultants' clients. Key findings include –

- More than half of the consultants or their affiliates offer products and services to both pension plans and to mutual funds on an ongoing basis.
- A majority of pension consultants have affiliated broker dealers, providing a mechanism for the money managers to compensate, or "curry favor" with, pension consultants.
- Many pension consultants do not adequately disclose material conflicts of interest to their pension plan clients. For example, pension consultants do not disclose, or inadequately disclose, compensation from the money managers they recommend to pension plan clients.

According to the report, many pension consultants avoid being considered a "fiduciary" as defined by ERISA. Nonetheless, as investment advisers, pension consultants still have fiduciary duties under the Advisers Act – responsibilities that the report asserts that many pension consultants are not aware of or have ignored.

The SEC report includes specific recommendations for pension consultants, including requirements for new policies and procedures that would –

- insulate pension consulting activities from other business activities to mitigate conflicts,
- ensure adequate disclosure of consultants' compensation, including from brokerage transactions, and
- prevent conflicts, or ensure disclosure of material conflicts to clients.

5. DOL Guidance on Asset Allocation Services

Retirement plans and plan participants are more frequently asking for asset allocation and other investment advisory services, and financial institutions have sought to respond to this demand. However, these services raise issues under the prohibited transaction rules of ERISA section 406 and Internal Revenue Code section 4975, especially where retirement plan investments include affiliated mutual funds or other "proprietary" investment products, or if mutual funds may pay fees under "12b-1 plans" or similar arrangements. DOL has already issued several advisory opinions and other interpretations on approaches to avoiding prohibited transactions in connection with asset allocation and other investment management services. A recent advisory opinion, issued to COUNTRY Trust Bank, DOL Adv. Op. 2005-10A (May 11, 2005), provides additional guidance but is not (as suggested by some news reports) a "shot across the bow" warning to financial institutions against conflicts of interest.

COUNTRY Trust (the "Bank") initially requested that DOL issue an individual prohibited transaction exemption for a program of asset allocation and investment management services offered to individual retirement accounts (IRAs). DOL responded in the form of an advisory opinion because the proposed program would not involve any prohibited transactions. Under the program, the Bank would use model investment strategies to invest the IRAs' assets among mutual funds, some advised by the Bank ("Affiliated Funds") and some not affiliated with the Bank ("Non-Affiliated Funds"). The IRAs would pay an annual investment fee based on the total value of IRA assets in the program (declining from 1.75% to 1.25% of assets). The Bank could also receive certain advisory and

non-advisory fees from the Affiliated Funds, but would reduce the investment fees otherwise payable by the IRAs by the total amount of fees it received from the Affiliated Funds. (It was represented that the Bank would not receive fees from the Non-Affiliated Funds.) Because of this offset arrangement, DOL agreed that the Bank's receipt of fees from the Affiliated Funds would not violate the prohibitions against self-dealing and conflicts under the Internal Revenue Code (Code sections 4975(c)(1)(E) and (F)). (If the Bank offered the program to ERISA-covered plans, the same analysis and conclusions would apply under the provisions of ERISA section 406(b).)

The analysis and conclusions in Advisory Opinion 2005-10A are not surprising – rather DOL has only confirmed that its analysis in Advisory Opinion 97-15A (Qualified Plans 97-6), issued to Frost National Bank, extends to affiliated mutual funds as well as to non-affiliated mutual funds. In the "Frost Letter," DOL explained that a bank with authority to select and substitute mutual fund investment options available to participants under a participant-directed plan was a "fiduciary," and thus could violate the prohibited transaction provisions under ERISA and the Internal Revenue Code by receiving 12b-1 or other fees from the mutual funds. However, the opinion also stated that the bank could avoid violations of the prohibited transaction rules if it used all amounts received from the mutual funds to offset fees the plans would otherwise pay on a dollar-for-dollar basis. The difference between the Frost Letter and Advisory Opinion 2005-10A is that Frost did not offer affiliated mutual funds – rather, it would receive fees only from unaffiliated funds. Advisory Opinion 2005-10A simply makes it clear that a dollar-for-dollar offset addresses the conflicts raised by fees paid from affiliated as well as unaffiliated mutual funds.

We note that the "dollar-for-dollar" offset approach described by Advisory Opinion 2005-10A is not the exclusive approach for financial institutions that wish to provide asset allocation and investment management services to plans and IRAs. For example, many financial institutions are offering asset allocation services to 401(k) plan participants with the assistance of "independent experts" who take responsibility for determining asset allocation recommendations, under programs designed to follow guidance under DOL Advisory Opinion 2001-09A (December 14, 2001). Financial institutions also may rely on one or more individual or class exemptions issued by DOL, such as Prohibited Transaction Class Exemption (PTE) 77-4.

6. **DOL Blesses In-kind Investments in Unregistered Pooled Funds**

The Department of Labor ("DOL") recently issued Advisory Opinion 2005-09A (May 11, 2005) (the "AO") to Vanguard Fiduciary Trust Company ("VFTC"), recognizing that ERISA section 408(b)(8) gives exemptive relief to a fiduciary who causes the in-kind investment of plan assets in, or withdrawal of assets from, a bank or insurance company pooled investment vehicle.

Section 408(b)(8) of ERISA provides an exemption from the prohibited transaction rules for the investment of plan assets in certain pooled investment vehicles, including (i) a common or collective trust fund or pooled investment fund maintained by a party in interest which is a bank or trust company supervised by a State or Federal agency or (ii) a pooled investment fund of an insurance company qualified to do business in a State, if certain conditions are satisfied. In 1996, the DOL indicated that this exemption covers the self-dealing rules of ERISA section 406(b)(1) and (2), not only the party-in-interest prohibitions of section 406(a).

In the new AO, DOL confirmed that the prohibited transaction relief of section 408(b)(8) under the 1996 opinion extends to transactions involving in-kind purchases and sales of interests in pooled investment vehicles, not merely cash transactions. The AO indicates that VFTC maintains certain collective investment trusts under a "master-feeder" structure, whereby a plan invests in a "feeder" fund which, in turn, is invested (on a discretionary basis by VFTC as trustee) in several other VFTC-maintained "master" collective funds. VFTC proposed to close certain master funds and move the distributed assets in-kind into new master funds. VFTC expressed concern that, in the absence of an exemption, these transactions may result in violations of ERISA sections 406(b)(1) (self-dealing) and/or 406(b)(2) (conflict of interest). DOL confirmed that "section 408(b)(8) of ERISA would permit an in-kind exchange of securities owned by a plan or fund holding 'plan assets' for units or interests in a collective investment fund," provided that the conditions of the exemption are met. In this respect, DOL specifically noted that the trustee must have in place conditions for guaranteeing proper pricing of the in-kind assets to ensure that a plan pays no more than "reasonable compensation."

The AO has important implications for banks and trust companies that maintain common and collective trust funds, and for insurance companies that maintain pooled separate accounts. First, it confirms the scope of relief suggested by the 1996 advisory opinion, an important point for many banks and trust companies who have begun to "rediscover" collective investment funds as alternatives to mutual fund investments. Second, it affirms the availability of the exemption for "transitioning" client assets in-kind both into and between pooled investment vehicles.

7. **Tenth Circuit Deals Another Blow to Broad-Based COLI**

In Tillman v. Camelot Music, Inc., the Tenth Circuit recently ruled that proceeds from a corporate-owned life insurance ("COLI") policy purchased on a rank-and-file employee's life were not payable to the employer as the policy's owner and beneficiary because the employer did not have an "insurable interest" in the employee under Oklahoma law. 2005 WL 1112086 (10th Cir. 2005). This new blow to broad-based COLI programs may well spawn additional litigation in the area.

A. Background

COLI policies have been an attractive way to fund, among other things, retiree medical benefits and deferred compensation plans. The popularity of the policies has been rooted in the tax-free receipt of death proceeds and the deductibility of policy loan interest. In 1986, however, Congress limited the deductibility of policy loan interest to policies with face amounts up to \$50,000. In response to the change in the law, and to maximize the limited deduction, many COLI programs were designed to cover a large number of employees. In the late 90s, Congress further restricted the use of "broad-based" COLI programs by limiting the interest deduction to policies on the lives of a small number of the corporation's "key persons" (still subject to the \$50,000 limitation).

In recent years, the IRS has challenged the allowance of interest deductions with respect to "broad-based" leveraged COLI policies, and won victories against a number of large taxpayers in the courts. Among the arguments advanced by the IRS was that a corporation purchasing COLI policies had no "insurable interest" in the lives of its employees under state law and, therefore, such policies did not meet the definition of "life insurance" under the Code (sec. 7702).

Early in 2004, the Fifth Circuit became the first appellate court in many years to rule that an employer (Wal-Mart) purchasing a COLI policy on the life of a rank-and-file employee does not have an "insurable interest" in the life of the employee. Mayo v. Hartford Life Insurance Company, 354 F.3d 400 (5th Cir. 2004). Specifically, the Fifth Circuit ruled that the mere existence of an "employment relationship" was not sufficient to create an "insurable interest" in the life of an "ordinary" (i.e., non-key) employee under Texas law – holding that the COLI proceeds were payable to the relatives or the personal representative of the deceased employee instead of the employer.

B. Tenth Circuit Decision

In 1990, Camelot Music, Inc. ("Camelot") purchased 1,400 COLI policies to insure the lives of all of its full time employees in order to "help offset the cost of employee health benefits." At the time, Tillman was a full time rank-and-file employee of Camelot. Four years after his death (and during Camelot's bankruptcy proceedings), his personal representative brought suit claiming that the insurance proceeds of the COLI policy were payable to Tillman's estate, not Camelot. The argument was based on Oklahoma law which provides, "if anyone takes out a contract of insurance, delivered or issued for delivery within the state [of Oklahoma], on a person in whom it does not have an insurable interest, the insured or his representative may maintain a cause of action to recover the proceeds." Camelot contended that Oklahoma law did not govern the terms of the COLI policy because the policy was not "delivered" in Oklahoma, and that it had an "insurable interest" in Mr. Tillman.

The court first examined whether the COLI policy was "actually" or "constructively" delivered in the state of Oklahoma. The court found no evidence indicating that the policy was physically delivered to Camelot (or Tillman) in the state of Oklahoma. Because Camelot filed the COLI policy with the Oklahoma Department of Insurance (the "Department") for approval, the court found that the "delivery" to the Department raised an inference of "constructive delivery," thereby subjecting the policy to Oklahoma law. The court noted that to require "physical" delivery would allow insurance companies to avoid the application of Oklahoma law altogether, a result that is counter to the underlying intent of regulating insurance in the state.

The court then examined whether Camelot had an "insurable interest" in Tillman. The court first found that it was well-established that corporations

have an "insurable interest" in their "key employees." The court further found that, in deciding whether an "insurable interest" exists under Oklahoma law, it must determine whether a party procuring insurance on another has "a lawful and substantial economic interest in having the life, health, or bodily safety of the individual insured continue."

The district court's finding that a "substantial economic interest" in Mr. Tillman's life existed rested on the fact that Camelot provided all of its full time employees a complete benefits package, including medical insurance, a profit sharing/401(k) plan and life insurance. The appeals court, however, likened these costs to routine "start-up" costs associated with Camelot's "general employees," not costs exclusively associated with employees of "special importance" to the company. The court thus concluded that Camelot failed to establish that it had a "lawful and substantial economic interest" in Mr. Tillman's continued life, and this did not have an "insurable interest."

C. Observations/Pending Tax Legislation

To date, the Fifth and Tenth Circuits are the only ones to hold that an employer does not have an "insurable interest" in a rank-and-file employee under a "broad-based" COLI program. Because the issue of whether an "insurable interest" exists is strictly based on state law, employers who have purchased "broad-based" COLI programs (or maintain trust-owned life insurance plans, such as for FAS 106 funding) should review their respective state "insurable interest" laws. In this regard, many states have amended their insurance laws to grant employers an insurable interest (subject typically to employee consent), but multistate employers may not necessarily be protected by them (depending, for example, on how conflicts of laws principles are applied).

The Tillman ruling is not expected to impact the current legislative proposal relating to the tax treatment of COLI policies (included most recently in the National Employee Savings and Trust Equity Guarantee Act of 2005, S. 219). The COLI amendment in the current Senate NESTEG bill, which generally would apply to contracts issued after the date of enactment –

- Provides that death benefits paid under "employer-owned life insurance" would be taxable to the extent the benefits exceed the premiums or other amounts paid for the contract, unless certain

notice and consent requirements are satisfied and –

- the insured was an employee within 12 months of death;
 - the insured is a "highly compensated employee" under Code section 414(q) (without regard to the top-paid group rules) or a "highly compensated individual" under IRC section 105(h)(5) with a salary in the top 35 percent of employees, including any director; or
 - the benefits are payable to the individual's family, designated beneficiary (other than the employer), a trust for the benefit of such persons, or the individual's estate, or are used to purchase an equity interest in the employer from any of such persons.
- Requires that, prior to the issuance of the contract, the employee must (1) be notified in writing of the coverage and the maximum face amount for which the employee could be insured at issuance, (2) be informed in writing that the employer will be the beneficiary of any death benefits under the policy, and (3) provide written consent to being insured and to the coverage continuing after the employee's termination of employment.
 - Imposes annual reporting and recordkeeping requirements on employers who maintain employer-owned life insurance programs.

Of course, these tax changes, if enacted, still would not affect state law "insurable interest" determinations.

Comments are due July 25 with a public hearing scheduled for August 17.

8. IRS Proposes Rewrite of Section 415 Regulations

On May 25, IRS and Treasury released proposed regulations that coordinate and update the IRS Code section 415 limits on benefits and

contributions under qualified plans. 70 Fed. Reg. _____ (May 31, 2005). Although the primary impact of the section 415 limits is on section 401(a) qualified plans, certain provisions apply to contributions to section 403(b) plans, and the "compensation" definition is widely used in calculating permissible plan contributions, e.g., in IRAs and 457(b) plans.

The complex and lengthy proposed rules address a wide variety of "open" issues, modify prior positions in a few areas, and incorporate the many amendments to section 415 that Congress has made over the nearly 25 years since the current regulations were published (as well as the related IRS guidance scattered in rulings, notices and revenue procedures). IRS generally proposes to require compliance with the final version of these rules for 2007 and later limitation years, subject to certain transition provisions based on compliance with the current rules. We will provide a detailed summary with the next issue.

9. Restrictive IRS Position on "Grace Period" Funding For Multiemployer Plans

Recent IRS Private Letter Ruling 200517034 addresses the ability of a multiemployer plan to count employer contributions made during the 8½-month grace period (permitted under Code section 412(c)(10)) "for the [earlier] plan year" for minimum funding purposes. The IRS generally has prevailed in the courts in challenging the ability of employers contributing to multiemployer plans to deduct (under Code sec. 404(a)(6)) "grace period" contributions on the prior year's tax return because the bargained-for contributions are typically based on hours worked during specific payroll periods. Although the IRS has ruled that the Code's grace period provisions for funding and deductions are "independent," the IRS now says that "does not mean inconsistent." Thus, in the PLR, IRS rejected the plan's request to count the grace period contributions towards prior year funding requirements except to the extent that they actually relate to work performed in the prior plan year (e.g., contributions received in January for December work under a calendar year plan).

This IRS letter ruling comes as an unpleasant surprise to multiemployer plans, many of which are struggling to avoid funding deficiencies related to the severe investment losses of 2000 – 2002, declining covered employment levels and/or heavy retirements. Recent IRS Notice 2005-40 (May 23 IRS Bulletin) allows certain multiemployer plans to

elect to defer charges for certain losses for their 2004 and 2005 plan years, but the relief – if available at all – is temporary and there are numerous conditions and restrictions, including notification of all participants.

10. IRS Guidance for Pre-Approved Plans

IRS Announcements 2005-36 and 2005-37 (May 23 IRS Bulletin) clarify a number of issues for pre-approved plans, including GUST and EGTRRA filing deadlines and a practitioner's authority to amend volume submitter plans. Specifically, Announcement 2005-36 clarifies the following points:

- **GUST Filings:** The GUST pre-approved defined contribution ("DC") program will close as of June 15, 2005. Therefore, applications for GUST opinion or advisory letters must be postmarked by such date. Thereafter, no GUST letters will be issued for such pre-approved plans. The Service will announce at a later date the closing of the GUST programs for defined benefit pre-approved and individually designed plans.
- **EGTRRA Filings:** The EGTRRA filing deadline for mass submitter and national sponsor plans is October 31, 2005, and is January 31, 2006 for non-mass submitter pre-approved DC plans.

Announcement 2005-37 adopts a three-step procedure for volume submitter (VS) practitioners to amend plans on behalf of adopting employers. As described in Rev. Proc. 2005-16 (Qualified Plans 2005-2), this authority extends to changes in the Code, regulations, revenue rulings, and other statements published by the Service, including model, sample or other good faith amendments, and corrections of prior approved plans. This implementing amendment will be reviewed as part of EGTRRA if adopted prior to submission of the EGTRRA filing.

- **Send Form and Amendment:** The VS practitioner must send an authorization form and a copy of the proposed amendment (sample plan language is provided in the Announcement) to each adopting employer. The authorization

form should require the employer to state whether it accepts or rejects the practitioner's authority to amend on its behalf, and should inform the employer that a rejection (and failure to adopt another pre-approved plan) will result in the plan becoming an individually designed plan.

- **Employer Return Form:** Each employer must return the completed form to the VS practitioner, signed and dated. (It is unclear whether the employer's failure to return the form results in its plan becoming an individually designed plan).
- **Adoption of the Amendment:** The VS practitioner generally should not adopt the implementing amendment for a plan until it receives responses from all adopting employers. Once adopted, the VS practitioner must make all required and discretionary amendments for adopting employers. However, depending on the circumstances, the employer may also need to sign the amendments. (The language leaves room for negative elections procedures.)
- **Automatic Rollover Amendments:** Special interim relief is granted for certain automatic rollover amendments (Qualified Plans 2005-2) adopted by VS practitioners before the general implementing amendment is adopted. In that case, the VS practitioner must follow the procedures set forth above within 60 calendar days of May 9, 2005 – *i.e.*, all forms must be distributed and returned, and the amendment adopted, by July 8, 2005. Also, the effective date of the implementing amendment should be retroactive to the effective date of the automatic rollover amendment. Ann. 2005-37.

Once implemented, VS practitioners (which should include sponsors of volume submitter plans) will have amendment authority similar to sponsors of M&P plans, which should facilitate adoption of Code-related amendments.