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BENEFITS BRIEF

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IRS Rules Could Limit QSERPs

The IRS recently proposed regulations that could limit the ability of companies to utilize so-called “QSERPs.” After providing some background on QSERPs below, we describe the impact of the proposed rules. The IRS’s new rules are included in regulations primarily addressing nondiscrimination testing relief for “closed plans.” 81 Fed. Reg. 4976 (Jan. 29, 2016).

A QSERP is an arrangement where a company provides a disproportionately larger benefit accrual for certain highly compensated employees (“HCEs”) in a tax-qualified pension plan (e.g., the designated HCEs earn a 1.5% of pay accrual and other plan participants earn a 1% of pay accrual). The qualified pension plan document frequently identifies the HCEs who receive the larger benefit by their names or some portion of their social security numbers. A QSERP often effectively “moves” all or a part of a participant’s benefits under a nonqualified pension plan or “SERP” into a qualified pension plan. The amount of the additional qualified plan benefit for each HCE has to be carefully determined to ensure that the plan passes “general testing” under the IRS discrimination rules. And in any event, a participant’s total benefit under a qualified pension plan cannot exceed the Internal Revenue Code (“Code”) section 415 limits on the amount of plan benefits.

QSERPs have been around for many years, and the IRS has issued favorable determination letters on many tax-qualified pension plans containing them. And the regulations under Code Section 409A contain a provision that accommodates the “movement” of benefits from nonqualified pension plans to qualified plans via a QSERP (as well as other qualified plan increases that reduce nonqualified plan benefits). However, concerns were raised with QSERPs following a front page article on them in the *Wall Street Journal* in August 2008. The Treasury Department and the Government Accountability Office (“GAO”) then responded to Congressional inquiries on them, and the Retirement Fairness Act of 2009 was introduced to address concerns on QSERPs (but never went anywhere). But there has not been any particular attention focused on QSERPs in recent years.

Under the newly proposed regulations, the IRS would require that the group of participants benefitting under a QSERP that is utilizing the general test must meet the “reasonable classification” requirement under the IRS nondiscrimination rules. These rules would then require that such a classification of participants benefitting under a QSERP must be reasonable and based on objective business criteria. Generally this classification can be based on specified job categories, a geographic location, the nature of compensation (salaried, hourly) or other bona fide business criteria. The enumeration of employees by name (or criteria having substantially the same effect) typically utilized in a QSERP arrangement does <u>not</u> meet the reasonable classification test.

Given this potential change in IRS rules, companies may need to review any ongoing or planned QSERP. And if the regulations are finalized in their current form, companies may need to revise the description of the group benefitting under an ongoing QSERP in a manner that meets the reasonable classification test or cease accruals under the QSERP (which would likely require an ERISA section 204(h) notice 45 days in advance of the change).

The IRS rules would not be effective until the plan year beginning after the final regulations are published. The IRS has requested comments on the proposed regulations and scheduled a hearing on the regulations for May 19, 2016. If you are interested in commenting on the regulations or have questions on these rules, please contact your regular Groom attorney or one of the attorneys listed above.