

## Comments Regarding Possible Issues under Internal Revenue Code Section 414(x)

October 14, 2009

Department of Treasury  
Internal Revenue Service  
Notice 2009-71

The American Society of Pension Professionals & Actuaries (ASPPA) appreciates this opportunity to comment on possible issues to be addressed in guidance under IRC §414(x). These comments are submitted pursuant to the request made in Notice 2009-71.

ASPPA is a national organization of more than 6,500 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, administrators, actuaries, accountants and attorneys. Our large and broad-based membership gives ASPPA unique insight into current practical applications of ERISA and qualified retirement plans, with a particular focus on the issues faced by small- to medium-sized employers. ASPPA's membership is diverse but united by a common dedication to the employer-sponsored retirement plan system. All credentialed actuarial members of ASPPA are members of the ASPPA College of Pension Actuaries (ASPPA COPA), which has primary responsibility for the content of comment letters that involve actuarial issues.

### Summary of Recommendations

IRC §414(x) spells out special rules for combined defined benefit and employee cash or deferred arrangement plans. The broad intent of ASPPA comments is to ask for clarification that, in those areas not specifically addressed within IRC §414(x), current law and regulations will apply to eligible combined plans as separate defined benefit and employee cash or deferred arrangement plans. Key recommendations, which are described in greater detail in the Discussion of Issues section, include:

- ASPPA recommends that guidance clarify that a combination plan can be established using a single document or two separate documents;
- ASPPA recommends that guidance clarify that the minimum benefit formulas defined under IRC §414(x)(2) are considered safe harbors for purposes of the



nondiscrimination rules. If benefits in excess of those minimums are provided, nondiscrimination testing should be based on total benefits.

- ASPPA recommends that guidance clarify that the minimum benefits defined under IRC §414(x)(2)(B) are deemed to meet the 133 1/3 percent accrual rule. When benefits and contributions in excess of the minimums defined under IRC §414(x)(2) are provided, testing of the additional benefit formula should be done on a standalone basis, such as is provided for in the “greater of” formula guidance.

With the tools to establish an eligible combined plan, and to build on the minimum benefit structure, we believe the eligible combined plan can be a popular design.

## Discussion of Issues

### I. Single Plan Status

While key benefits are associated with the documentation and administrative advantages of using a single plan and single trust, it is our view that an eligible combined plan under IRC §414(x) is indeed comprised of two separate plans – a defined benefit (DB) plan and a defined contribution (DC) plan. Section 414(x) says it is not an IRC §414(k) plan, thus, it is not a single plan with IRC §4975 applied to the combination as if the aggregation were a DB plan. For example, the Joint Committee report highlights that just the DB portion would be limited to investing 10% of plan assets in employer securities.

This characterization is also supportive of language in IRC §414(x)(2)(A)(iii) about a separate allocation of assets to the extent necessary for the separate application of this title under subparagraph (1), and the corresponding ERISA language in ERISA §210(e) (the latter supporting the notion that the plans are separate for Title IV so that the DC assets are not considered in applying priority categories, for example).

*ASPPA recommends* that guidance should reinforce this characterization.

Consistent with this approach, guidance should clarify that:

- a. Assets of the DB subaccount in the combined trust are not available to pay benefits attributable to the DC plan -- and vice versa.
- b. IRC §404(a)(7) applies to a combined plan as if the DB component and the DC component were separate plans.
- c. The QJSA rules are applied separately to the DB and DC portions of the plan.
- d. The automatic enrollment portion of the DC arrangement can utilize the EACA permissive withdrawal provisions.
- e. The restrictions of IRC §436 apply only to the DB portion of the plan.

## II. Plan documentation

Early guidance is needed regarding how an eligible combined plan is formed, and the deadline for adopting an eligible combined plan for 2010.

- a. While a single document containing both DB and DC features is one of the key benefits of using the §414(x) model, a single document should not be mandated to gain access to the safe harbors offered by IRC §414(x). The notion of separate documents is well supported by current rules that look to asset “pools” and acknowledge that plans can use multiple documents to comprise a single plan. Conversely, a single document can comprise multiple plans by specifying how pools are restricted and available only to specified groups.

*ASPPA recommends* that early agency guidance provide that a combination plan can be established using a single document or two separate documents. If two documents are used, prototype documents, separate individually designed plans, or a combination of the two should be permissible. A plan sponsor utilizing separate plan documents could acknowledge IRC §414(x) status in a wrap document or through an election of the arrangement indicated on the Form 5500. Longer term, a single prototype document should be available.

Guidance should also provide that a plan sponsor currently maintaining a DB and DC plan is permitted to amend those plans to conform to the requirements under IRC §414(x) without having to freeze or terminate the current plans and begin anew. If such plans have different plan years, and uniform plan years are required, where the DB plan year is changed we recommend that guidance under the funding rules allow for automatic approval of the change in valuation date without any timing limitations that might otherwise apply.

- b. Given the short period of time between now and January 1, 2010 when the option becomes available, an employer may have difficulty adopting plans and providing any necessary participant notices.

*ASPPA recommends* that guidance should include transitional relief in the form of extended due dates for adoption, notice requirements, and mid-year implementation. If the employer does not currently maintain a 401(k) plan, we would anticipate that adoption of the eligible combined plan would need to occur prior to the making of any elective deferrals, as would be the rule for a standalone 401(k). Where an employer is combining two existing plans or adding a DB plan to an existing 401(k) document, we suggest that the deadline follow the rules for discretionary amendments (adopt by the end of the plan year).

### III. Nondiscrimination

Eligible combined plans must meet certain minimum benefit requirements. Early guidance should address how the minimum benefits interact with the nondiscrimination rules.

- a. *ASPPA recommends* that, for the DB portion of the plan, guidance should confirm that a combined plan that provides the minimum benefits described in IRC §414(x)(2)(B)(ii) or, if an applicable plan, the minimum percentages in IRC §414(x)(2)(B)(iii), is deemed to pass IRC §401(a)(4).

In addition, safe harbor rules should be provided for an applicable defined benefit plan to provide pay credits in excess of the minimum percentages in IRC §414(x)(2)(B)(iii). We suggest that a modified formula be treated as satisfying the formula requirements of clause (iii) if the age brackets in the formula in clause (iii) are not modified, the percentage for each age bracket is no less than the percentage for such age bracket in the formula in clause (iii), and the percentage stated in the modified formula for any age bracket bears a ratio to the percentage stated in the modified formula for the immediately preceding age bracket which is no greater than the ratio that the corresponding percentage for such age bracket in the formula in clause (iii) bears to the percentage stated in the formula in clause (iii) for the immediately preceding age bracket.

- b. Guidance should be provided regarding testing when benefits in excess of the minimums are provided. *ASPPA recommends* that guidance clarify that testing would be based on total benefits, not those in excess of the minimum, and that non-elective contributions to the DC portion of the plan could be aggregated with the DB benefits for testing purposes.
- c. Guidance should also address whether the DB and DC components of the combined plan could include a floor-offset arrangement if the arrangement meets the safe harbor rules for 401(a)(4) purposes and the requirement for the exception under 401(a)(26).

### IV. Accrual rules

Implementation of an eligible combined plan will require clarification of several issues related to the accrual rules:

- a. Plan sponsors that adopt an eligible combined plan to minimize costs will want to minimize testing requirements. *ASPPA requests* that guidance include an explicit statement of whether an applicable plan providing the pay credits stated in IRC §414(x)(2)(B)(iii) would be deemed to pass the 133 1/3 accrual rules. If so, guidance should also clarify that any formula in the plan *in addition to the minimum formulas* would require testing on a stand-alone basis much like the “greater of” formula testing currently in place.

- b. Plan sponsors with existing defined benefit plans may want to amend the plan to comply with the eligible combined plan rules. *ASPPA recommends* that guidance clarify that the accrual formulas are prospective, not based on the service credited under a current plan that might be converted to the DB portion of an eligible combination plan or on service before the effective date of a new plan.
- c. *ASPPA requests* clarification that the 1 percent formula in IRC §414(x)(2)(B)(ii) is life only, and could be actuarial equivalent for another form. We also request that the basis for equivalence be included in the guidance.

## V. Average Compensation

IRC §414(x)(2)(B)(i) states that the benefit provided by the defined benefit portion of the plan must be no less than an applicable percentage of a participant's "final average pay." The term "final average pay" is not defined for the purpose of this minimum benefit requirement.

*ASPPA recommends* that guidance clarify that a plan may specify compensation for the purposes of determining a minimum benefit under §414(x)(2)(B)(i) as any definition of compensation permitted under the published regulations under IRC §414(s). Guidance should also clarify that all of the rules listed under Treasury Regulation §1.401(a)(4)-3(e)(2) for determining average annual compensation also apply to determine final average pay under §414(x)(2)(B)(i).

## VI. Uniformity

IRC §414(x)(2)(E) states that all contributions and benefits offered under each component of a combined plan must be provided uniformly for all participants. However, the requirements for benefits to be "uniformly provided" are not defined within §414(x). It appears that varying benefits based on age do not violate the uniformity requirement since IRC §414(x)(2)(B)(iii) anticipates a benefit formula where benefits are based directly upon a participant's age. Guidance is needed with regard to what other factors may be considered. For example, proposed regulation §1.411(b)(5)-1(b)(5) provides for comparison of benefits for "similarly situated employees" and concludes that an individual is similarly situated to another individual if the individual is identical to that other individual in every respect that is relevant in determining a participant's benefit under the plan other than age (including period of service, compensation, position, date of hire, work history, and any other respect.)

*ASPPA recommends* that that guidance clarify how factors such as those outlined in the similarly situated standard can be applied (in addition to age) in determining whether benefits are considered uniformly provided within a combination plan.

## VII. Small Employer

An eligible combined plan can only be set up by a “small employer”, that is, a controlled group with at least 2 employees at the time the plan is established and an average of 2 to 500 employees over business days of the prior calendar year. We read this to mean that there can be more than 500 employees at or after the time of plan establishment and that there can be more than 500 employees on some days during the prior calendar year as long as the average daily count for the year is 500 or less.

- a. *ASPPA recommends* that guidance confirm that there can be more than 500 employees on some days during the prior calendar year as long as the average daily count for the year is 500 or less and provide examples such as:

An employer with 2 employees every business day from January 1 to July 31 and 1,000 employees on every business day from August 1 to December 31 (i.e., the average is less than 500) could set up a combined plan on January 1 of the next year as long as there are more than 2 employees on that day (i.e., even though there are 1,000 or more).

- b. While the referenced 4980D section does not include any exceptions such as carve outs for short service or youthful employees, the omission of 414(n) points to the exclusion of leased employees from the small employer determination. *ASPPA recommends* that guidance confirm that leased employees are excluded from the small employer determination.

## VIII. Contribution Requirements

An eligible combined plan must meet the contribution requirements of IRC §414(x)(2)(C).

- a. IRC §414(x)(2)(C)(i)(I) requires that the cash or deferred portion of the plan be an automatic contribution arrangement. IRC §414(x)(5) states that such an arrangement requires contributions of 4 percent of compensation unless the employee elects otherwise.

Clarification is needed as to whether 4% of compensation requirement is absolute, or if the contribution can be increased through automatic increases or through an initial higher entry-level contribution. *ASPPA recommends* that guidance clarify that the 4% of compensation requirement is a floor and increased automatic contribution levels are permitted.

- b. IRC §414(x)(2)(C)(i)(II) provides for a required matching contribution of at least 50% of salary deferral contributions up to 4% of compensation. Notice 2009-71 provides that the plan can use a different matching formula as long as it meets certain requirements (i.e., the rate of match cannot increase as deferrals

increase and HCEs cannot receive more than NHCEs). IRC §414(x)(2)(D)(i) also makes reference to matching contributions that exceed the required minimum of 50% up to 4% when discussing the vesting requirements.

Clarification is needed as to whether the match in excess of 50% of salary deferral up to 4% of compensation can be discretionary or whether it must be stated in the plan document. *ASPPA recommends* that a match above the required minimum should be permitted to be a discretionary contribution (like the safe harbor rules).

## **IX. Vesting**

*ASPPA requests* clarification that if existing plans are amended to form a combined plan, the accelerated vesting rules apply only to accruals earned after the effective date of the combined plan.

## **X. Reporting**

Guidance will be needed as to whether a separate Schedule C or H/I will be required for the DB/DC components or will it be optional (permitted, not required). *ASPPA recommends* separate schedules be permitted, but not required.

### **Issue for Future Consideration**

In addition to the issues described above, there are a number of questions that will need to be clarified in future guidance. These issues include:

- a. *How are eligible combined plans split apart into non-eligible combined plans (such as in the case of the termination of one part of the arrangement and not the other)?*  
In keeping with our initial thoughts above about these arrangements being two separate plans at the core, we believe that freezing, terminating, or amending in such a way as to fall short of the minimum requirements of IRC §414(x) merely results in the loss of the IRC §414(x) safe harbors and the requirement to file separate Form 5500s in the future. With regard to a mid-year transaction, guidance should address if safe harbor status is retained for the period prior to the change with separate testing of the period after the change, or if safe harbor status is lost for the full year. The Service is currently addressing the issue of mid-year changes of IRC §401(k) safe harbor status. We believe comparable treatment would apply to this situation.
- b. *Does small employer status follow the plan in the case of a merger & acquisition?*  
The small employer definition does not require a change in access to the eligible combined plan rules merely because of growth beyond the 500 employee limit. Agency guidance should explain whether changes in controlled group entities require a re-evaluation of small employer status. In the absence of a specific requirement in the law, ASPPA believes an eligible combined plan retains its status

as an eligible combined plan despite adoption by additional controlled group entities even if those entities were not part of the group measured at the time of the establishment of the plan. This would seem to be the only possible response in the case of asset acquisitions, and provides comparable treatment for stock-based transactions.

- c. *What are the ramifications of merging additional employee groups into an existing plan?* Agency guidance should confirm that additional business entities in a controlled group can merge their existing plans into the eligible combined plan and apply the relevant §414(x) minimums and other requirements without compromising the plan's status as an eligible combined plan.
- d. *What happens when an eligible combined plan is split into two eligible combined plans for subgroups of employees?* We anticipate that this would occur in connection with a business transaction that changes the employer's controlled group status. In such cases, we see no reason why each new spunoff plan would not continue to be an eligible combined plan without regard to the size of either of the spun off entities at the time of the spinoff.
- e. *How are these plans merged with other plans of the current employer (and its controlled group)?* An employer might choose to use an IRC §414(x) combination plan for some but not all employees. If the employer chooses to expand the group eligible for participation at a future date, guidance should address any restrictions on doing so based on merging in other predecessor plans or on the size of the employer at the time of the expansion.



These comments were prepared by the ASPPA Government Affairs Committee in coordination with ASPPA COPA. Please contact us if you have any questions or comments regarding the matters discussed above. Thank you very much for your consideration of these comments.

Sincerely,

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