

ARE YOU QUALIFIED?

Protecting the System's Qualified Status and Providing the Best Tax Treatment for Members' Benefits

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ATTACHMENT A BASIC PLAN QUALIFICATION REQUIREMENTS FOR A
GOVERNMENTAL DEFINED BENEFIT 401(a) PLAN.....1

ARE YOU QUALIFIED?

Protecting the System's Qualified Status and Providing the Best Tax Treatment for Members' Benefits

I. Role of the System Counsel or Compliance Officer

A. Type of Plan

1. Most governmental retirement systems have been established and maintained as qualified governmental plans under the Internal Revenue Code ("IRC" or "Code") § 401(a). In order to protect that status and provide favorable tax treatment for members' benefits, counsel should be aware of qualification requirements.
2. The sources of requirements for a qualified plan include:
 - a. The Code as amended by Congress. The Pension Protection Act of 2006 ("PPA"), the Heroes Earnings Assistance and Relief Act of 2008 ("HEART"), and the Worker, Retiree, and Employer Recovery Act of 2008 ("WRERA") are the most recent major enactments. See Attachment A.
 - b. Treasury Regulations, interpreting the Code. The most recent Treasury Regulations of interest include the Final 415 Regulations.
 - c. Revenue Procedures.
 - d. Revenue Rulings. For example, the IRS has dealt with pick-ups primarily with revenue rulings.
 - e. Notices.
 - f. Other – Announcements, Newsletters.
3. Alternative plans include:
 - a. 457(b) - Deferred Compensation – See Final Regs and model language.
 - b. 403(b) - Tax Sheltered Annuities – See Final Regs and model language. See also Rev. Proc. 2013-22 (procedures for issuing opinion and advisory letters for 403(b) pre-approved plans).
 - c. Non-qualified Plans – 457(f) and 409A.

B. Plan Document

1. Plan document must be identified (constitution, statutes, rules).
2. Qualified plan must be administered in accordance with plan document.
3. Plan document must contain required tax compliance language.

II. Why is Qualification So Important?

A. Taxation

1. Employer contributions are not taxable to members as they are made (or even when vested); taxation only occurs when plan distributions are made.
2. Earnings and income are not taxed to the trust or the members (until distribution).
3. Certain favorable tax treatments may be available to members when they receive plan distributions, for example, the ability to rollover eligible distributions.
4. Employers and members do not pay employment taxes (even if the positions are Social Security covered) when contributions are made or when benefits are paid.
5. Tax recapture available for qualified plans in tax treaty countries.

B. Bankruptcy

Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCA") provides greater protection for retirement funds, including IRAs, that qualify for favorable federal tax treatment.

III. Why is it So Important to be a Governmental Plan?

A. Exemption from ERISA

1. Governmental plans are exempt from the Employee Retirement Income Security Act of 1974 ("ERISA"). Exemption from Title I is found in Section 3(32) of ERISA.
2. Governmental plans are exempt from Pension Benefit Guaranty Corporation ("PBGC") premium payments. Exemption from Title IV is found in Section 4021(b)(2).

B. Limited Application of IRC

1. IRC § 401(a) currently has 37 separate paragraphs, each setting forth a qualification requirement. However, governmental plans are exempt from many Code requirements, including many time consuming and costly testing requirements. See flush language at end of Code Section 401(a). See attachment.
2. IRC § 414(d) defines a government plan for IRC purposes.
3. The Treasury, IRS, DOL and PBGC are meeting to work out a consistent interpretation of "governmental plans" for all purposes. The Departments issued an advanced notice of proposed rulemaking which would define "governmental plan."
 - a. IRS has taken the position that no non-governmental employees or employers may participate in governmental plan.
 - b. DOL has permitted a de minimis number of non-governmental employees.

C. Special Favorable IRC Provisions

1. Employee contributions may be "picked-up" and thereby treated as pre-tax when contributions are made. (IRC § 414(h)(2))
2. State and local government plans have favorable grandfathering and transitional rules under IRS guidance. (See, for example, final 415 regulations or 401(a)(17) limits)
3. Special limits on benefits that are more favorable apply to governmental plans. (IRC § 415(b), for example)
4. Special service purchase opportunities exist only for governmental plans. (IRC § 415(n), for example)

IV. How Does Counsel Know For Sure that Its Plans are Qualified?

- A. The IRS issues "determination letters" which confirm the qualified status of a retirement plan.
1. Form 5300 is the IRS application form.
 2. IRS has adopted staggered remedial amendment period (Rev. Proc. 2007-44).
 - a. Cycle C is for governmental plans (February 1, 2008 – January 31, 2009). (Next Cycle C is February 1, 2013 – January 31, 2014.)

- b. IRS gave sponsors of individually designed governmental plans the option of electing to use either Cycle C (February 1, 2013 – January 31, 2014) or Cycle E (February 1, 2015 – January 31, 2016) as their second remedial amendment cycle (Rev. Proc. 2012-50).
 - c. Notice 2010-90 Cumulative list.
 - d. Interim and discretionary amendments.
 - e. IRS adopted extended remedial amendment period for governmental plans that receive favorable determination letter. (Rev. Proc. 2009-36).
3. "Off-cycle" filings are discouraged.
- B. For issues related to governmental plan status and the taxation of contributions and benefits, the IRS issues "private letter rulings." PLRs only bind the IRS with respect to the taxpayer to whom the letter is issued.
 - C. Each year the IRS issues revenue procedures setting forth procedures and fees. (See Revenue Procedures 2013-1 through 2013-8)
 - D. Certain compliance failures may be addressed through self-correction or IRS approved correction in "EPCRS." (Rev. Proc. 2013-12)
 - E. IRS is embarking on a compliance initiative for governmental plans.

V. Definitions

- A. Basic Definition: What is a Pension Plan?
 - 1. Plan established and maintained by an employer or employers. (IRC § 401(a)(1); Rev. Rul. 72-240, 1972-1 C.B. 108)
 - 2. Each plan's assets must be held in trust as determined under state law. (IRC § 401(a)(1))
 - 3. Trustees must exercise fiduciary duties. (IRC § 401(a)(2))
 - 4. Primarily to provide systematically for the payment of definitely determinable benefits. See also IRC § 401(a)(8) – in a defined benefit plan, forfeitures must not be applied to increase the benefits any employee would receive under the plan. Treas. Reg. § 1.401-7. Forfeitures may be used for plan expenses or to offset employer contributions.
 - 5. To employees over a period of years, usually for life, after retirement. (Treas. Reg. § 1.401-1(b)(1)(i))

B. Other Definitions to Consider – IRC § 414

Code Section 414 contains many definitions that must be considered including:

1. IRC § 414(d) – Governmental Plan.
2. IRC § 414(g) – Plan Administrator.
3. IRC § 414(h) – Tax Treatment of Certain Contributions ("Pick-Ups").
4. IRC § 414(i) – Defined Contribution Plan.
5. IRC § 414(j) – Defined Benefit Plan.
6. IRC § 414(k) – Certain Plans ("Hybrid Plan").
7. IRC § 414(n) – Employee Leasing.
8. IRC § 414(p) – Qualified Domestic Relations Order.
9. IRC § 414(s) – Compensation.
10. IRC § 414(u) – Special Rules Relating to Veterans' Reemployment Rights under USERRA.
11. IRC § 414(v) – Catch-up Contributions for Individuals Age 50 or Over.
12. IRC § 414(w) – Special Rules for Certain Withdrawals From Eligible Automatic Contribution Arrangements.
13. IRC § 414(x) – Special Rules for Eligible Combined Deferred Benefit Plans and Qualified Cash or Deferred Arrangements ("DB/k Plan").

C. Pension Plan: Areas of Inquiry

1. General
 - a. Medical benefits. (Treas. Reg. § 1.401-14; IRC § 401(h))
 - b. In-service distributions, including refunds of contributions during employment. (Treas. Reg. § 1.401-1(a)(2)(i)).
 - i. PPA permits in-service distributions if plan so provides. (IRC § 401(a)(36))
 - ii. IRS issued final regulations on normal retirement age. Treas. Reg. § 1.401(a)-1(b); Notice 2007-69. Final regulations do not apply to governmental plans until 2015 (Notice 2012-29).

- c. Statement of actuarial assumptions. (IRC § 401(a)(25))
 - d. Death and disability benefits ("incidental benefits"). (Treas. Reg. § 1.401-1(b)(1)(i))
2. Some Special Issues
- a. 13th checks.
 - b. DROP plans.
 - c. Compliance with 401(h) requirements for medical benefits.
 - i. Only means of paying medical benefits from pension plan.
 - ii. Limited to retiree, spouse, dependents.

VI. Exclusive Benefit Rule

A. Code Requirements

- 1. The plan must be established and operated for the exclusive benefit of employees and their beneficiaries.
- 2. The plan must make it impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries . . . for any of the corpus or income to be . . . used for, or diverted to, purposes other than for the exclusive benefit of employees or their beneficiaries (IRC § 401(a)(2))

B. Exclusive Benefit Rule: Areas of Inquiry

- 1. Payments to other than the members and their survivors.
- 2. Investments that do not meet fiduciary standards.
- 3. Diversion of assets.
- 4. Return of contributions to employer.
- 5. QDROs – IRC § 414(p).
- 6. Garnishment.

VII. Prohibited Transactions

- A. The plan may not engage in "prohibited transactions." (IRC § 503(b))
- B. Prohibited Transactions: Areas of Inquiry

1. Self-dealing in investments.
2. Loans.

VIII. What Type of Plan is it?

- A. A defined contribution plan. (IRC § 414(i))
- B. A defined benefit plan. (IRC § 414(j))
- C. A hybrid defined benefit plan. (IRC § 414(k))

IX. Who Can be a Member?

- A. To maintain qualified governmental status:
 1. Only employees of governmental employers may be members of the plan. (IRS position)
 2. Only contributions from these employers and their employees may be made to the plan. (IRC §§ 401(a)(1) and 414(d))
- B. Governmental Plan Status: Areas of Inquiry
 1. Privatization.
 2. Coverage of non-governmental entities; coverage of non-governmental employees (union representatives; see IRC § 413).
 3. Cooperatives.
 4. Contracting Out and In.
 5. Charter Schools.
 6. Utility Districts.
 7. Volunteer Fire Companies (See IRC § 457(e)(11)(A)(ii)).
 8. Indian Tribal Governments.

X. Mandatory vs. Optional Membership

- A. If the plan (defined contribution or defined benefit) provides for optional participation, the option must be a one-time irrevocable election or a grandfathered cash or deferred arrangement. (Rev. Rul. 2006-43; IRC § 401(k); Treas. Reg. § 1.401(k)-1(a)(3)(v))

B. Membership Options: Areas of Inquiry

1. Optional participation.
2. Ongoing or revocable elections.
3. "Special Pay" Plans.

XI. Vesting

A. Code Requirement

1. Governmental plans are subject to pre-ERISA vesting rules – "the vesting requirements resulting from the application of Sections 401(a)(4) and 401(a)(7) as in effect in September 1, 1974." (IRC § 411(e))
2. Plan must provide 100% vesting if there is a partial or complete termination of the plan, or complete discontinuance of contributions, but in either situation only to the extent benefits are funded. (Treas. Reg. § 1.401-6)
3. Pre-ERISA vesting would also request 100% vesting of accrued benefit at normal retirement age. (Rev. Rul. 66-11, 1966-1 C.B. 71)

B. Vesting: Areas of Inquiry

1. Spin-offs.
2. Privatization.
3. Implementation of benefit tiers.
4. Plan termination (in whole or in part).
5. Frozen plans.

XII. Limits on Contributions

A. Code Requirements

1. All annual additions to a defined contribution plan and post-tax employee contributions to a defined benefit plan are capped by the limit on "annual additions" to pension plan – the lesser of 100% of compensation or \$40,000 (adjusted for inflation by the IRS) (IRC § 415(c)) – \$51,000 for 2013.
2. Exceptions to these limits for permissive service credit purchases in a defined benefit plan. (IRC § 415(n); see PPA § 821)

3. Restoration of withdrawals. (IRC § 415(k)(3))
 4. If the employer plan provides for a pick-up of members' mandatory contributions, the pick-ups must be in compliance with IRS guidelines, and then will be tested under IRC § 415(b). (IRC § 414(h); Rev. Rul. 2006-43; see final 415 regulations)
 5. Rollovers.
 6. Transfers.
- B. Contribution Limits: Areas of Inquiry
1. Final 415 regulations. (April 5, 2007)
 2. Definition of Compensation. (IRC § 415(c)(3))
 3. Picked-up Contribution. (IRC § 414(h)(2); Rev. Rul. 77-462, 1977-2 C.B. 358; Rev. Rul. 81-35, 1981-1 C.B. 255; Rev. Rul. 87-10, 1987-1 C.B. 156; Rev. Rul. 2006-43, 2006-35 IRB 329)
 - a. Employer paying contributions in lieu of employee.
 - b. Employee has no option of receiving picked-up amounts.
 - c. Official action.
 - d. Timing of pick-up.
 - e. Irrevocable elections.

XIII. Limits on Benefits

- A. Code Requirements
1. Benefits from a defined benefit plan are subject to the "dollar limit" – \$160,000 (adjusted for inflation by the IRS) (IRC § 415(b)) – \$205,000 for 2013.
 2. Benefit tested as the straight life annuity. Benefits that are not paid as a straight life annuity must be converted using IRS required factors.
- B. Benefit Limits: Areas of Inquiry
1. Final 415 regulations.
 2. Service retirement with fewer than 10 years of service.
 3. Early retirement (IRC § 415(b)(2)(C)) – before age 62.

4. Special limits for public safety employees. (IRC § 415(b)(2)(G)-(H))
5. Post-retirement adjustments.
6. Establishment of Qualified Excess Benefit Arrangement to handle excess benefits. (IRC § 415(m))

XIV. Limits on Compensation

A. Code Requirements

1. The plan must limit the compensation that may be considered to \$200,000 in determining benefits (as adjusted for inflation) (IRC § 401(a)(17)) – \$255,000 for 2013.
 - a. For employee contribution calculation (generally not for employer contribution purposes).
 - b. For benefit calculation.
2. Certain employees are grandfathered.
 - a. Look at plan provisions on July 1, 1993.
 - b. Participants who first joined prior to plan year beginning after December 31, 1995.
 - c. Timely amended for limits.

B. Compensation Limits: Areas of Inquiry

1. Plan Year vs. Calendar Year.
2. Year-by-year application.

XV. Required Benefit Payments

A. Code Requirements

1. The plan must set forth the IRC's distribution requirements and contain statements that the plan will comply with those requirements notwithstanding any of the plan's distribution provisions. (IRC § 401(a)(9))
2. Benefit must be distributed or begin to be distributed by the required beginning date (RBD) – April 1 of the calendar year that follows the calendar year in which the participant attains 70½ or separates from service, whichever is later. (IRC § 401(a)(9)(C))

3. Benefits must be distributed over the period of life of the employee or over the lives of such employee and a designated beneficiary (or over a period not extending beyond life expectancy(ies)). (IRC § 401(a)(9)(A)(ii)).
4. Benefits must meet the post-retirement minimum distribution incidental benefit (MDIB) requirement. (Treas. Reg. § 401(a)(9)-6, Q&A-2)
5. IRS has issued final regulations under 401(a)(9) for defined contribution and defined benefit plans. (Treas. Reg. § 1.401(a)(9)-1 through § 1.401(a)(9)-9) PPA also establishes a good faith, reasonable compliance standard for governmental plans. (PPA § 823)
6. Required minimum distributions under IRC § 401(a)(9) are suspended during calendar year 2009 for defined contribution plans. See IRC § 401(a)(9)(H), as added by WRERA § 201(a).
7. The plan must provide that, for a participant who dies while performing qualified military service, the survivors of the participant are entitled to any additional benefits (such as accelerated vesting, ancillary life insurance benefits, or other survivor benefits contingent on termination of employment on account of death; but other than benefit accruals relating to the period of qualified military service) provided under the plan as if the participant had resumed and terminated employment on account of his or her death. (IRC § 401(a)(37), added by HEART § 104(a)). See IRS Notice 2010-15.

B. Required Benefit Payments: Areas of Inquiry

1. Assuring that benefits begin by the required beginning date (RBD).
2. Assuring that the required minimum distribution (RMD) is made.
3. Tracking down participants and beneficiaries.
4. Testing survivor benefits under the incidental benefit rules.
5. Grandfathered provisions (Treas. Reg. § 1.401(a)(9)-6, Q&A-16) and/or good faith, reasonable compliance.
6. Providing benefits for survivors of participants who die while performing qualified military service.

XVI. Rollovers

A. Code Requirements

1. The plan must provide for rollovers by employees and spouses and give the appropriate notices. (IRC § 401(a)(31)(A))

2. Rollovers are permitted out of and into:
 - a. qualified plans,
 - b. 403(b) plans,
 - c. governmental 457(b) plans, and
 - d. IRAs (See PPA § 824 – Direct Rollover to Roth IRAs in 2008; see WRERA § 108(d) – Removal of restrictions for rollovers to Roth IRAs for plan years beginning before 2010 and tax-free rollovers from a designated Roth account to a Roth IRA).
3. PPA § 829 permits qualified plan to provide for non-spouse beneficiary rollover to inherited IRA. WRERA § 108(f) makes non-spouse beneficiary rollovers mandatory for plan years after December 31, 2009.
4. Retirement plans are not required to accept all types of rollovers; these are permissive.
5. Automatic rollovers are required for mandatory distributions over \$1,000 to missing or non-consenting participants. (IRC § 401(a)(31)(B))

B. Rollovers: Areas of Inquiry

1. Identifying eligible rollover distributions. (IRC § 402(c)(4))
2. Identifying eligible retirement plans. (IRC § 402(c)(8)(B))
3. Using rollovers for service purchases.
4. Maintaining limitations on in-service distributions.
5. Compliance with notice requirements. (IRC § 402(f); Treas. Reg. § 1.402(f)-1); note IRS Notice 2009-68)
6. After-tax dollars. (See PPA § 822; see WRERA § 108(d))
7. Implementing non-spouse beneficiary rollover (required for plan years after December 31, 2009; see WRERA § 108(f)).
8. Implementing Roth Rollovers. (See the American Tax Relief Act of 2012 which permits an in-plan Roth rollover for any amount held for the benefit of an employee, whether or not that amount is otherwise eligible for distribution).
9. Implementing rollovers of lump-sum distributions from a defined contribution plan to a defined benefit plan, where such amounts are converted to an immediate annuity. (See Rev. Rul. 2012-4).

XVII. Group Trust

- A. A qualified plan may be invested in a group trust. Revenue Rulings 81-100, 2004-67, and 2011-1.
- B. Assets of qualified plans (401(a)), 457(b) plans, deemed IRAs (including Roth IRAs), 403(b)(7) custodial accounts, and 403(b)(9) retirement income accounts may be commingled for investment purposes.
- C. Revenue Ruling 2011-1 provides updated guidance:
 - 1. A governmental plan described in Code Section 401(a)(24) may also participate in a group trust. This includes both a governmental plan that provides pension benefits and a governmental plan that provides other employee benefits for retirees, such as retiree welfare benefits. Therefore, a governmental plan providing retiree welfare benefits will be treated as a Code Section 401(a)(24) plan and may invest in a group trust. This should allow many Code Section 115 and OPEB retiree health trusts to participate in group trusts.
 - 2. Each adopting entity must be tax-exempt under Code Section 501(a) or not subject to federal income tax.
 - 3. Each adopting entity must be part of a plan that satisfies an exclusive benefit rule (i.e., it is impossible for any part of the corpus or income of the plan to be used for, or diverted to, purposes other than for the exclusive benefit of the plan participants and their beneficiaries).

XVIII. Taxation of Benefits

- A. The plan must follow IRC and IRS guidance for tax withholding and reporting procedures, including the taxation of disability benefits.
- B. Numerous IRC provisions including §§ 72, 101(h), 104 and 402.
 - 1. Code Section 72 sets forth general rule that gross income includes income from annuities, and provides for the recovery of basis and for certain tax penalties.
 - a. IRC § 72(c) – Definitions.
 - b. IRC § 72(d) – Special Rules for Qualified Employer Retirement Plans.
 - c. IRC § 72(e) – Amounts Not Received as Annuities.
 - d. IRC § 72(m) – Special Rules Applicable to Employee Annuities and Distribution Under Employee Plans.

- e. IRC § 72(p) – Loans Treated as Distributions.
 - f. IRC § 72(t) – 10-Percent Additional Tax on Early Distributions from Qualified Retirement Plans.
2. Code Section 101(h) – Survivor Benefits Attributable to Service by a Public Safety Officer Who is Killed in Line of Duty.
 3. Code Section 104(a) – Line of Duty Disability Benefits.
 4. Code Section 402 – Taxability of Beneficiary of Employees' Trust
 - a. IRC § 402(a) – Taxation of a 401(a) trust distribution is subject to IRC § 72.
 - b. IRC § 402(c) – Rollovers.
 - c. IRC § 402(e) – Other Rules Applicable to Exempt Trusts.
 - d. IRC § 402(f) – Written Explanation to Recipients of Distributions Eligible for Rollover Treatment – "Safe Harbor Notice."
 - e. IRC § 402(g) – Limitation on Exclusion for Elective Deferrals.
 - f. IRC § 402(l) – Distributions from Governmental Plans for Health and Long-Term Care Insurance.
- C. PPA, HEART, and WRERA Changes
1. Penalty free withdrawal by certain individuals called to active duty. (IRC § 72(t)(2)(G), made permanent under HEART § 107(a) and WRERA § 108(e))
 2. Waiver of 10% penalty for public safety employees. (IRC § 72(t)(10))
 3. \$3,000 exclusion for certain deductions for public safety officers. (IRC § 402(l))
- D. Taxation: Areas of Inquiry
1. Treatment of line of duty death and disability benefits.
 2. Implementation of PPA, HEART, and WRERA.
 3. Recordkeeping of "tax basis."
 - a. Forms review.
 - b. 1099-R compliance review.

4. Withholding on nonresident aliens.

CIRCULAR 230 DISCLOSURE

Except to the extent that this advice concerns the qualification of any qualified plan, to ensure compliance with recently-enacted U.S. Treasury Department Regulations, we are now required to advise you that, unless otherwise expressly indicated, any federal tax advice contained in this communication, including any attachments, is not intended or written by us to be used, and cannot be used, by anyone for the purpose of avoiding federal tax penalties that may be imposed by the federal government or for promoting, marketing, or recommending to another party any tax-related matters addressed herein.

This publication is intended for general information purposes only and does not and is not intended to constitute legal advice. The reader must consult with legal counsel to determine how laws or decisions discussed herein apply to the reader's specific circumstances.

ATTACHMENT A

BASIC PLAN QUALIFICATION REQUIREMENTS FOR A GOVERNMENTAL DEFINED BENEFIT 401(a) PLAN

LIST OF CODE SECTIONS APPLICABLE TO GOVERNMENTAL PLANS

Code Requirement

DEFINITION OF INTERNAL REVENUE CODE

The Internal Revenue Code should be defined in the Plan in accordance with state drafting rules.

CODE SECTION 401(a)(1)

Formal Plan Required. A qualified plan that allows contributions to a trust for the sole purpose of distributing benefits to employees and beneficiaries with favorable tax treatment must be written. Contributions may be made only by (i) the employer, (ii) the employees, or (iii) both the employer and the employees. Plan must be administered in accordance with its terms.

"Pension Plan": a pension plan is a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to employees over a period of years, usually for life, after retirement. Treas. Reg. § 1.401-1(b)(1)(i).

Definitely Determinable Benefit: for a defined benefit plan, requirement is satisfied where the benefit (including disability, death and early retirement) for each participant can be computed in accordance with an express formula contained in the plan. Rev. Rul. 74-385; Treas. Reg. § 1.401-1(b)(1)(i). See also Code § 401(a)(25) (if benefit is determined on the basis of actuarial assumptions, such assumptions must be specified in plan so as to preclude employer discretion).

Mortality Tables. For a defined benefit plan, the IRS requires specific provisions setting forth the actuarial assumptions to be used in determining actuarial equivalence.

Incidental Benefit rules (non-retirement benefits, e.g., disability and death benefits). Treas. Reg. § 1.401-1(b)(1).

CODE SECTION 401(a)(2)

Exclusive Benefit to Employees. All qualified plan assets must be used exclusively for the benefit of employees or their beneficiaries. This rule involves a review of both form and operation.

In order to comply with this "exclusive benefit" rule, it must also be shown that not only are payments made solely to members and their beneficiaries, but also that payments made to beneficiaries are incidental to those payments made to the member.

Nondiversion of Trust Funds: Plan must make it impossible prior to satisfaction of all liabilities for funds to be diverted for purposes other than exclusive benefit of employees or beneficiaries. Treas. Reg. § 1.401-2(a)(2).

No In-Service Distributions: Generally, a member may not receive distributions from a qualified plan prior to death, disability, separation from service, termination of plan, or attainment of normal retirement age.

Note: Code Section 401(a)(36) and IRS Final Regulations on Normal Retirement Age. Treas. Reg. § 1.401(a)-1(b).

CODE SECTION 401(a)(7)

Vesting Requirements. Pre-ERISA minimum vesting standards, requiring 100% vesting upon retirement and upon plan termination or discontinuance of employer contributions, must be met.

- Rev. Rul. 66-11: Requires full vesting at normal retirement age and completion of required years of service.

CODE SECTION 401(a)(8)

Forfeitures. Forfeitures may not be used to increase plan benefits in a defined benefit plan.

CODE SECTION 401(a)(9)

Required Distributions. Governmental plans must make distributions to an employee no later than April 1 of the calendar year in which he or she attains age 70½ or in which he or she retires, if later. The basic rule is that such distributions must be over the life of the employee or over the lives of the employee and a designated beneficiary or over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and a designated beneficiary. If an employee dies before his/her entire interest is distributed, the remaining portion must be distributed at least as rapidly as under the method of distribution being used at the date of death. If an employee dies before distribution of his/her interest has begun, the entire interest must be distributed over the beneficiaries lifetime or within 5 years after the employee's death. There are limited exceptions to the 5-year rule, and special rules if the surviving spouse is the designated beneficiary.

IRC § 4974 provides a penalty for failure to make minimum distribution.

Note: Final Regulations provide for transitional period and grandfathering of certain benefits, as well as good faith, reasonable interpretation by governmental plans.

CODE SECTION 401(a)(16)

Benefits or contributions may not exceed 415 limits. See 415 discussion below.

CODE SECTION 401(a)(17)

Maximum Compensation. For years beginning after December 31, 2001, the compensation limit will be increased to \$200,000 and indexed thereafter in \$5,000 increments as determined by the IRS. Certain governmental employees who qualify as eligible participants are grandfathered to limit in effect under plan on 7/1/93.

CODE SECTION 401(a)(24)

Participation in Group Trusts. A group trust can remain tax-exempt while accepting funds from a governmental plan or government maintained 457(b) plan or accepting funds intended to satisfy governmental obligations with respect to such plans.

CODE SECTION 401(a)(25)

Stated Actuarial Assumptions. Whenever the amount of any benefit is determined on the basis of actuarial assumptions, a defined benefit plan must specify actuarial assumptions in a manner that precludes employer discretion in order to provide definitely determinable benefits.

CODE SECTION 401(a)(31)

Eligible Rollover Distribution. This section requires a plan to permit distributees to elect to have an eligible rollover distribution paid directly to an eligible retirement plan specified by the distributee in a direct rollover. For distributions made after December 31, 2001, plans may permit participants to rollover account balances among 401(a) plans, 403(b) tax-sheltered annuities, and 457 governmental deferred compensation plans. In addition, rollovers may be allowed from IRAs to these employer retirement plans. After-tax contributions in qualified plans may be rolled over to defined contribution and defined benefit plans and 403(b) plans that will account for them separately or to IRAs. Surviving spouses may be permitted to rollover distributions to a qualified plan, 403(b) plan, or 457 plan. Starting in 2007, non-spouse rollovers are permissible to inherited IRAs. Starting in 2008, rollover to Roth IRA must be offered by qualified plan. Also, the law provides a hardship exception to the requirement that rollovers be made within 60 days of distribution, permitting the IRS to waive the 60 day requirement if the failure to do so would be against equity or good conscience.

Notes: Code Section 402(c) provides total and partial rollover and distribution rules, and general tax rules. Code Section 402(f) establishes a notice requirement and Code Section 6652 sets a penalty for failure to give notice.

CODE SECTION 401(a)(36)

In-Service Distributions. Added by PPA §905. Final Regulations were published on May 22, 2007, clarifying that a pension plan (a defined benefit plan or money purchase pension plan established under Internal Revenue Code Section 401(a)) may be designed to allow the payment of benefits when an employee reaches normal retirement age but hasn't yet terminated employment. The final regulations then address three age ranges and establish a "safe harbor" for a plan with a normal retirement age of age 62 or older. The final regulations also provide a special rule for pension plans in which substantially all of the participants are "qualified public safety employees." Pursuant to Notice 2009-86, the effective date of the Final Regulations for governmental plans is plan years beginning on or after January 1, 2013. Notice 2012-29 extended the effective date for governmental plans to plan years beginning on or after the later of (1) January 1, 2015 or (2) the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after the date that is 3 months after the final regulations are published in the Federal Register.

CODE SECTION 401(a)(37)

Mandatory Survivor Benefits. This section requires the plan to provide that, in the case of a participant who dies while performing qualified military service (as defined in section 414(u)), the survivors of the participant are entitled to any additional benefits (other than benefit accruals relating to the period of qualified military service) provided under the plan had the participant resumed and then terminated employment on account of death. HEART § 104(a).

CODE SECTION 401(b)

Establishes required amendment periods for qualified plans. See Rev. Proc. 2007-44.

CODE SECTION 401(h)

Retiree Medical Benefits. Pension or annuity plan may provide limited sickness, accident, hospitalization and medical benefits for retirees, their spouses and their dependents.

CODE SECTION 401(k)

Cash or Deferred Arrangements. Governmental organizations generally cannot maintain a qualified cash or deferred arrangement. However, the Code contains an exemption for arrangements adopted by governmental plans before May 6, 1986. Those plans would have to conform to appropriate 401(k) provisions.

Optional participation in other retirement plans raise an issue as to whether such an option creates a cash or deferred arrangement, but the IRS regulations provide that a one-time irrevocable election by an employee to participate in a retirement plan, which election is available at the time of employment or at the time participation is first available, does not render a governmental plan a 401(k) plan.

CODE SECTION 413

Collectively Bargained Plans and Multiple Employer Plans

CODE SECTION 414(d)

Governmental Plan. Defined as "a plan established and maintained by its employees by ... the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing." The inclusion of non-governmental or quasi-governmental employers/employees can cause loss of governmental plan status.

Note: IRS, DOL, and PBGC have an ongoing regulations project on this definition.

CODE SECTION 414(h)

Government "Pick-ups". Allows a government entity to treat certain employee contributions as employer contributions. Revenue rulings have established the following requirements for an effective pick-up:

- The employer must take formal action, evidenced by a contemporaneous written document, specifying that the contributions, although designated as employee contributions, are being paid by the employer in lieu of contributions by the employee. A person duly authorized to take such action with respect to the employer must do so. The action must apply prospectively only.
- The employee must not be given the option, from and after the date of the pick-up, to have a cash or deferred election right (within the meaning of § 1.401(k)-1(a)(3)) with respect to the designated employee contributions. Thus, the employees must not be able to opt out of the pick-up or be able to receive the contributed amounts directly instead of having them paid by the employer to the pension plan.

Rev. Rul. 2006-43; see also Rev. Rul. 81-35; Rev. Rul. 81-36; and Rev. Rul. 87-10.

Note: IRS approval obtained through PLR.

CODE SECTION 414(j)

Definition of Defined Benefit Plan. A defined benefit plan means any plan that is not a defined contribution plan, *i.e.*, "a plan that provides for an individual account for each participant and for benefits based solely on the amount contributed to the participant's account, and any income, expenses, gains and losses, and forfeitures of accounts of other participants which may be allocated to such participant's account." Code § 414(i).

CODE SECTION 414(n)

Leased Employees. Definitions for leased employees.

CODE SECTION 414(p)

Definition of Qualified Domestic Relations Order. A distribution from a governmental plan, which is not subject to Code § 401(a)(13), made pursuant to a domestic relations order will be treated as a QDRO if that order creates or recognizes the existence of an alternate payee's right to, or assigns to an alternate payee the right to, receive all or a portion of the benefits payable with respect to a participant under a plan. Code § 414(p)(1)(A)(i) and (ii).

Note: Governmental plans are not required to accept QDROs. However, if plan does make distributions under DROs that meet this definition, the appropriate tax consequences are determined by federal law.

CODE SECTION 414(u) and USERRA

Reemployed Veterans. The Uniformed Services Employment and Reemployment Rights Act of 1994 expanded veterans rights and included various retirement plan provisions in the Internal Revenue Code. Generally, make-up employee contributions required under DB plan not subject to 415 limits for year make-up contributions made, but subject to applicable limits for year to which the contributions relate.

- **HEART:** For years beginning after December 31, 2008, (1) an individual receiving a differential wage payment shall be treated as an employee of the employer making the payment; (2) the differential wage payment shall be treated as compensation; and (3) the plan shall not be treated as failing to meet the IRC 414(u)(1)(C) non-discrimination rule by reason of any contribution or benefit which is based on the differential wage payment.

Note: Final DOL Rules, IRS Notice 2010-15.

CODE SECTION 415(b)

Limitations on Benefits. Effective for years ending after December 31, 2001, the benefit limit will increase to \$160,000, with future indexing for inflation in \$5,000 increments as determined by the IRS. Special rules regarding benefit reductions apply to governmental plans and particularly plans maintained for certain police and fire plans. Governmental plans are not subject to the benefit limitation based upon 100% of salary.

Note: Final IRS Regulations were issued in May 2007.

CODE SECTION 415(c)

Limitations on Contributions. For years beginning after December 31, 2001, the annual additions limit is increased to the lesser of \$40,000 or 100% of compensation, with future indexing of the dollar limit for inflation in \$1,000 increments as determined by the IRS. The 415(c) limit is not applicable to picked-up contributions or the receipt of roll-over distributions.

Note: Final IRS Rules were issued in April 2007. Among the most significant changes were revisions to the definition of "compensation."

CODE SECTION 415(k)(3)

Repayments. In case of repayment (including interest) to plan with respect to an amount previously refunded upon a forfeiture of service credit under the plan or under another governmental plan maintained by a State or local government employer within the same State, any such repayment shall not be taken into account for purposes of Code § 415. After December 31, 2001, a governmental defined benefit plan may permit a trustee-to-trustee transfer from a 403(b) plan or a 457 plan to purchase permissive service credit (see Code § 415(n)) or to repay previously refunded contributions.

CODE SECTION 415(m)

Excess Benefits. The 1996 federal legislation authorizes the establishment of Qualified Excess Benefit Arrangements to deal with benefits and contributions in excess of 415 limits.

Note: IRS approval obtained through PLR.

CODE SECTION 415(n)

Service Purchases. Effective for 1998, there are modified 415(c) and 415(b) limits that apply to voluntary employee contributions for purchases of permissive service credit. After December 31, 2001, a governmental defined benefit plan may permit a trustee-to-trustee transfer from a 403(b) plan or a 457 plan to purchase permissive service credit or to repay contributions previously refunded under forfeiture of service credit (see Code § 415(k)(3)). Note: 1997 legislation also establishes a transitional rule for eligible participants to grandfather purchases of service allowable as of 8/5/97.

Note: IRS approval obtained through PLR.

CODE SECTION 503(b)

Prohibited Transactions. While governmental plan is not subject to excise tax of Code § 4975, engaging in prohibited transaction could result in loss of plan's tax-exempt status.

CODE SECTIONS 72, 101(h), 104, 402, and 3405

Governs taxation and withholding of various distributions from governmental plans.

LIST OF CODE SECTIONS NOT APPLICABLE TO GOVERNMENTAL PLANS

Code Section 401(a)(3) Coverage Rules
Code Section 401(a)(4) Nondiscrimination Rules
Code Section 401(a)(5) Nondiscrimination Rules
Code Section 401(a)(6) Nondiscrimination Rules
Code Section 401(a)(10) and 416 Top Heavy Plans
Code Section 401(a)(11) and 417 Joint and Survivor Rules*
Code Section 401(a)(12) and 414(l) Plan Merger
Code Section 401(a)(13) Anti-Alienation
Code Section 401(a)(14) Benefit Commencement Rules
Code Section 401(a)(15) Social Security Integration
Code Section 401(a)(19) Forfeiture Rules
Code Section 401(a)(20) Plan Termination
Code Section 401(a)(26) Participation
Code Section 401(a)(27) Profit Sharing Plans Only
Code Section 401(a)(28) Employee Stock Ownership Plans
Code Section 401(a)(29) 412 Plans Only
Code Section 401(a)(30) Elective Deferrals (except for grandfathered plans)
Code Section 401(a)(32) and 401(a)(33) Bankruptcy and Funding Rules
Code Section 401(a)(34) PBGC Covered Plans
Code Section 401(a)(35) Defined Contribution Plans
Code Section 410 Participation
Code Section 411* (Instead See Pre-ERISA 401(a)(7))
Code Section 412 (Instead See Pre-ERISA 401(a)(7))

* Code Sections 411 and 417 must be considered for 415(b) testing under Final Regulations.

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