Optional Forms of Benefit Under Defined Contribution Plans

Notice 98–29

Section 411(d)(6) of the Internal Revenue Code precludes qualified retirement plan amendments that have the effect of eliminating optional forms of benefit and further states, in § 411(d)(6)(B), that the Secretary may provide exceptions to this provision. The Internal Revenue Service and the Treasury Department are considering further guidance exercising this authority in order to address a number of concerns in this area. The Service and Treasury believe that any such relief should take into account the interests of participants and the practical needs of employers in effectively and efficiently providing retirement benefits for their employees, including the need to adapt plans to changing circumstances. The Service and Treasury are inviting comments on possible approaches before regulations are proposed.

BACKGROUND

Section 411(d)(6) generally provides that a plan is not treated as satisfying the requirements of § 411 if the accrued benefit of a participant is decreased by a plan amendment. Under § 411(d)(6)(B), a plan amendment that eliminates an optional form of benefit is treated as reducing accrued benefits to the extent that the amendment applies to benefits accrued as of the later of the adoption date or the effective date of the amendment. However, § 411(d)(6)(B) permits the Service and Treasury to provide exceptions to this rule. This authority does not extend to a plan amendment that would have the effect of eliminating or reducing an early retirement benefit or a retirement-type subsidy.

Regulatory exceptions to the application of § 411(d)(6)(B) to optional forms of benefit generally have been developed to address certain specific practical problems. For example, § 1.411(d)–4, Q&A-3(b) of the Income Tax Regulations permits a transfer of a participant's entire nonforfeitable benefit between plans to be made at the election of the participant, without a requirement that the transferee plan preserve all § 411(d)(6) protected benefits, but only if the participant is eligible to receive an immediate distribution and certain other conditions are satisfied.

The Service and Treasury recognize that the accumulation of a variety of payment choices under plans may increase the cost and complexity of plan operations. For example, an employer that initially adopted a plan form offered by a prototype sponsor may now be using a different prototype plan that offers a different array of distribution forms. The requirement to preserve the preexisting optional forms for benefits accrued up to the date of change in the prototype plan may present significant practical problems in certain cases.

Similar issues arise where employers merge with or acquire other businesses. These employers often face issues of whether to maintain separate plans, terminate one or more of the plans, or merge the plans. If an employer chooses to merge the plans, the resulting plan may accumulate a wide variety of optional forms, some of which may differ in insignificant ways or may entail special administrative costs. Because the existing elective transfer rule of § 1.411(d)–4, Q&A–3(b) applies only to terminated plans and to other situations in which a participant's benefits have become distributable, its applicability is limited.

Furthermore, it has become easier for individuals to duplicate the various payment choices available from qualified plans through other means. The Unemployment Compensation Amendments of 1992 substantially expanded participants' ability to transfer qualified plan distributions to individual retirement arrangements (IRAs) on a tax-deferred basis. Individuals who receive single-sum distributions from qualified plans frequently roll those distributions over directly to IRAs, under which distributions can be made in a wide variety of payment forms. There are also indications that the vast majority of participants in defined contribution plans who have a choice of options elect single-sum distributions, which are often rolled over to IRAs.

The Service and Treasury are weighing these considerations as they apply to various circumstances and various benefit forms, and expect to propose regulations that would allow greater flexibility with respect to plan payment forms.

Any § 411(d)(6) relief provided would not provide exceptions from other requirements of the Code. For example, any such relief would not permit a money purchase pension plan to be amended to eliminate any distribution form required by §§ 401(a)(11) and 417, and would not affect the requirements of § 401(a)(31) (relating to direct rollovers).

POSSIBLE RELIEF FOR DEFINED CONTRIBUTION PLANS

Under one approach being considered, a plan amendment to a defined contribution plan would not violate § 411(d)(6) merely because the amendment eliminated alternative forms of payment if, after the amendment, each affected participant could elect between a single-sum distribution form and at least one extended payment form. The extended payment form condition would be satisfied if the plan offered at least one of the following three alternatives: (1) a single and a joint life annuity, (2) installments payable over a single and a joint life expectancy, or (3) in the case of a plan that did not previously provide for payment of benefits to the participant in any form described in (1) or (2), installments payable over the longest installment period permitted under the plan before the amendment. Such an approach would apply to a plan amendment eliminating or restricting the availability of an alternative form of payment only if the amendment did not apply to a participant whose distribution began before the date the amendment was adopted or within 90 days thereafter.

In addition to comments on this approach, comments are invited on possible variations, which might include providing that the extended payment form condition could be satisfied by installments for a fixed number of years (such as five, ten, or twenty years), or by a provision under which a participant could elect to receive any amount of the participant's account balance at any time, or not requiring an extended payment form.

Such an approach would not permit the elimination or restriction of other features relating to a distribution form, including the time of commencement, and the right to receive payments in cash or in kind, to receive a partial distribution, or to accelerate payments. Under such an approach, absent other § 411(d)(6) relief, these other features would have to be retained for both the single-sum and extended payment forms. For example, a participant would have to be able to receive payment (under both the single-sum and extended payment forms) beginning whenever payments could have begun under any alternative form of payment that has been eliminated or restricted.

Comments are also requested on other possible approaches, including the following approaches that some have suggested:

- Permitting amendments that eliminate optional forms of benefit with respect to which participant utilization is demonstrably very low. This approach would require resolution of a variety of questions. For example, it would raise practical issues of substantiation and would require rules for separating and combining optional forms of benefit (in order to measure the utilization of any one optional form). Other issues would include whether only utilization by retirees or some other class of participants should be taken into account as the basis for measurements (such as all participants retiring within a specified period), and how such a utilization approach might coordinate with other § 411(d)(6) relief.
- Permitting amendments that eliminate optional forms of benefit that apply with respect to no more than a small portion of participants' benefits (such as cases in which an optional form of benefit is inapplicable to benefits attributable to contributions made after a specific date and the prior benefits represent no more than a small percentage of a participant's total benefit).
- Permitting amendments that eliminate optional forms of benefit if the effective date of the amendment is deferred for some period of years.

The Service and Treasury are also considering whether it would be appropriate to develop additional relief for elective transfers between defined contribution plans. Such relief would apply under certain conditions, for example, where employees are transferred to a new controlled group in connection with an acquisition. This would permit employers to allow employees of an acquired business to elect to have their benefits transferred between defined contribution plans, even though the benefits may not yet be distributable. Comments are requested on this approach and on whether the approach should be limited to situations in which both plans are of the same type (for example, the approach would be available if both plans are profit-sharing plans with qualified cash or deferred arrangements), or whether the transferee plan should merely be required to retain the distribution restrictions and other relevant characteristics of the transferor plan.

DEFINED BENEFIT PLANS

Defined benefit plans have special characteristics, including benefit payment calculation specifications and possible retirement-type subsidies (for which § 411(d)(6)(B) does not authorize the issuance of regulatory relief). See also S. Rep. No. 575, 98th Cong., 2d Sess. 30 (1984) (addressing issues with respect to elimination of optional forms of benefit). These features are not characteristic of defined contribution plans and provide special protections to participants. Comments are invited on whether additional § 411(d)(6) relief is appropriate in the context of defined benefit plans and, if so, how any relief might adequately take account of the special characteristics of defined benefit plans.

COMMENTS REQUESTED

The Service and Treasury invite comments on the possible approaches described in this notice. It is anticipated that further guidance in this area would take the form of proposed regulations. Comments should be submitted by August 31, 1998, in writing, and should reference Notice 98–29. Comments may be submitted by mail to—

Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Attn: CC:CORP: T:R (Notice 98–29), Room 5226
Washington, DC 20044;

or may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Notice 98–29), Courier's Desk, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC. Alternatively, comments may be submitted via the Internet at http://www.irs.ustreas.gov/prod/tax_regs/comments.html

DRAFTING INFORMATION

The principal authors of this notice are Linda Marshall of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations) and Kenneth Conn of the Employee Plans Division. For further information regarding this notice, please contact Ms. Marshall at (202) 622-6030 or Mr. Conn at (202) 622-6214. These are not toll-free numbers.