26 CFR 1.401–1: Qualified pension, profit-sharing, and stock bonus plans.
(Also §§ 404, 415, 4972; 1.415–6.)

Rev. Rul. 2002–45

Restorative payments; nondiscrimination; deductions; qualified defined contribution plan. This ruling describes two situations in which certain payments, which are termed "restorative payments" in the ruling, to a qualified defined contribution plan are not treated as contributions for various sections of the Code.

ISSUE

Under the facts described below, are payments to the trust of a defined contribution plan qualified under § 401(a) of the Internal Revenue Code (the Code) treated as contributions for purposes of § 401(a)(4), 401(k)(3), 401(m), 404, 415(c), or 4972?

FACTS

Situation 1. Employer M maintains Plan X, a defined contribution plan, for the benefit of M's employees. The plan is qualified under § 401(a). Employer M caused an unreasonably large portion of the assets of Plan X to be invested in Entity G, a high-risk investment. It is later determined that the investment has become worthless.

A group of participants in Plan X files a suit against Employer M alleging a breach of fiduciary duty in connection with the investment in Entity G. Following the filing of the suit, the parties agree to a settlement pursuant to which Employer M does not admit that a breach of fiduciary duty occurred but makes a payment to Plan X equal to the amount of the losses (including an appropriate adjustment to reflect lost earnings) to Plan X from the investment in Entity G. The settlement also provides that the payment will be allocated among the individual accounts of all of the participants and beneficiaries in proportion to each account's investment in Entity G over the appropriate period. The court approves the settlement and enters a consent order. Employer M makes the payment to Plan X and the payment is allocated to the appropriate accounts.

Situation 2. The facts are the same as in Situation 1, except that no lawsuit is filed against Employer M. However, Employer M becomes aware that participants in Plan X are concerned about the investment in Entity G and are considering taking legal action. Employer M also learns that lawsuits alleging fiduciary breach have been filed against other companies by those companies' employees over losses to their qualified retirement plans due to investment in Entity G. Employer M decides to make the payment to Plan X before a lawsuit is filed, after reasonably determining that it has a reasonable risk of liability for breach of fiduciary duty based on all of the relevant facts and circumstances.

LAW AND ANALYSIS

The provisions of the Code that apply to contributions to qualified defined contribution plans include §§ 401(a)(4), 401(k)(3), 401(m), 404, 415 and 4972.

Section 401(a)(4) generally provides that the contributions or benefits provided under a qualified defined contribution plan may not discriminate in favor of highly compensated employees. Whether contributions under a defined contribution plan are discriminatory is generally determined by comparing the amount of contributions allocated to the accounts of highly compensated employees with the amount of contributions allocated to the accounts of nonhighly compensated employees.

Section 401(k)(3) contains participation and nondiscrimination standards for elective deferrals to qualified cash or deferred arrangements. Section 401(m) contains nondiscrimination tests for matching contributions and employee contributions. Both § 401(k)(3) and § 401(m) provide rules regarding qualified matching contributions and qualified nonelective contributions.

Section 404 generally provides that contributions paid by an employer to or under a plan, if they would otherwise be deductible, are only deductible under § 404, subject to various limitations under § 404(a).

Section 415(c) generally limits the amount of contributions and other additions under a qualified defined contribution plan with respect to a participant for any year.

Section 4972(a) imposes a 10 percent excise tax on the amount of the nondeductible contributions made to any "qualified employer plan," including a plan qualified under § 401(a) or 403(a).

A payment made to a qualified defined contribution plan is not treated as a contribution to the plan, and accordingly is not subject to the Code provisions described above, if the payment is made to restore losses to the plan resulting from actions by a fiduciary for which there is a reasonable risk of liability for breach of a fiduciary duty under Title I of the Employee Retirement Income Security Act of 1974 (ERISA) and plan participants who are similarly situated are treated similarly with respect to the payment. For purposes of this revenue ruling, these payments are referred to as "restorative payments."

The determination of whether a payment to a qualified defined contribution plan is treated as a restorative payment, rather than as a contribution, is based on all of the relevant facts and circumstances. As a general rule, payments to a defined contribution plan are restorative payments for purposes of this revenue ruling only if the payments are made in order to restore some or all of the plan's losses due to an action (or a failure to act) that creates a reasonable risk of liability for breach of fiduciary duty. In contrast, payments made to a plan to make up for losses due to market fluctuations and that are not attributable to a fiduciary breach are generally treated as contributions and not as restorative payments. In no case will amounts paid in excess of the amount lost (including appropriate adjustments to reflect lost earnings) be considered restorative payments. Furthermore, payments that result in different treatment for similarly situated plan participants are not restorative payments. The failure to allocate a share of the payment to the account of a fiduciary responsible for the losses does not result in different treatment for similarly situated participants.

Payments to a plan made pursuant to a Department of Labor (DOL) order or court-approved settlement to restore losses to a qualified defined contribution plan on account of a breach of fiduciary duty generally are treated as having been made on account of a reasonable risk of liability.[1]

In no event are payments required under a plan or necessary to comply with a requirement of the Code considered restorative payments, even if the payments are delayed or otherwise made in circumstances under which there has been a breach of fiduciary duty. Thus, for example, while the payment of delinquent elective deferrals or employee contributions is part of an acceptable correction under the VFC Program, such payment is not a restorative payment for purposes of this revenue ruling. Similarly, payments made under the Employee Plans Compliance Resolution System (EPCRS), Rev. Proc. 2002–47, on page 133, of this Bulletin, or otherwise, to correct qualification failures are generally considered contributions and do not constitute restorative payments for purposes of this revenue ruling. However, the payment of appropriate adjustments to reflect lost earnings required under EPCRS is generally treated in the same manner as a restorative payment.

In Situation 1, the payment by Employer M to restore losses to Plan X on account of the investment in Entity G is made pursuant to a court-approved settlement of the suit filed against it by plan participants and is not in excess of the amount lost (including appropriate adjustments to reflect lost earnings). In Situation 2, the payment by Employer M is made after it reasonably determines, based on all of the relevant facts and circumstances, that it has a reasonable risk of liability for breach of fiduciary duty even though no suit has yet been filed. In reaching this determination, the following facts are taken into account: that Entity G was a high-risk investment, that a large portion of the plan assets had been invested in Entity G, that participants expressed concern about the investment, and that several lawsuits had been filed against other employers alleging fiduciary breach in connection with the investment of plan assets in Entity G.

In both Situation 1 and Situation 2, therefore, the payment is made based on a reasonable determination that there is a reasonable risk of liability for breach of fiduciary duty and to restore losses to the plan. In addition, the payment is allocated among the individual accounts of the participants and beneficiaries in proportion to each account's investment in Entity G so that similarly situated participants are not treated differently.

In both Situation 1 and Situation 2, the payment is a restorative payment (as defined in this revenue ruling) and, as such, is not a contribution to a qualified plan. Accordingly, the payment is not taken into account under § 401(a)(4) or 415(c) or, if applicable to the plan, § 401(k)(3) or (m). In addition, the restorative payments to Plan X are not subject to the provisions of § 404 or 4972.

HOLDING

The payments to the defined contribution plans qualified under § 401(a) under the facts described in Situation 1 and Situation 2 above are not contributions for purposes of § 401(a)(4), 401(k)(3), 401(m), 404, 415(c), or 4972.

Drafting Information

The principal author of this revenue ruling is Diane S. Bloom of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, please contact the Employee Plans' taxpayer assistance telephone service at 1–877–829–5500 (a toll-free number), between the hours of 8:00 a.m. and 6:30 p.m. Eastern time, Monday through Friday. Ms. Bloom may be reached at 1–202–283–9888 (not a toll-free number).

Section 404.—Deduction for Contributions of an Employer to an Employees' Trust or Annuity Plan and Compensation Under a Deferred-Payment Plan

Whether "restorative payments" to a qualified defined contribution plan are deductible contributions. See Rev. Rul. 2002–45, page 116.

Will the Service challenge the deductibility of certain contributions actually made during the taxable year in anticipation of section 401(k) deferrals and section 401(m) matching contributions? See Notice 2002–48, page 130.

[1] Whether a payment is made under the Voluntary Fiduciary Correction (VFC) Program established by the DOL may be taken into account in determining whether there is a reasonable risk of liability. Final rules describing the VFC Program were issued by the DOL on March 28, 2002 (67 **Fed. Reg.** 15062). The VFC Program is designed to encourage employers to voluntarily comply with Title I of ERISA by correcting certain violations of the law. If an applicant meets the VFC Program criteria it will receive a no action letter from the DOL, pursuant to which the DOL will neither initiate a civil investigation under ERISA regarding the applicant's responsibility for any transaction described in the letter nor assess a civil penalty under section 502(l) of ERISA on the correction amount paid to the plan or its participants.