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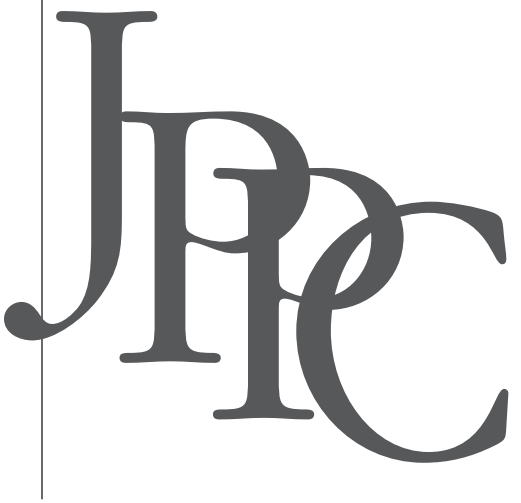

Defined Benefit Plan Termination: Exorcising the Excise Tax on Reversions

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INTRODUCTION

If a tax-qualified defined benefit plan terminates with assets exceeding plan benefits and liabilities, the excess can revert to the employer sponsor. Such a reversion amount is subject to a 50% excise tax in addition to employer income taxes. The excise tax rate, however, can be reduced to 20% of the reversion amount if the employer either increases benefits in the terminating plan or establishes a qualified replacement plan or both. This article describes the requirements to reduce the excise tax rate to 20% based on the available guidance.

REVERSION UPON PLAN TERMINATION

Internal Revenue Code (Code) Section 401(a)(2) provides one of the many requirements for a defined benefit retirement plan to be qualified under Code Section 401(a), which is that "under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of [the employer's employees] or their beneficiaries…."[1] Therefore, plan assets cannot revert to the employer upon a plan termination until all benefits have been distributed. Regulations require that "the trust instrument must definitely and affirmatively make it impossible for the nonexempt diversion or use to occur, whether by operation or natural termination of the trust, by power of revocation or amendment, by the happening of a contingency, by collateral arrangement, or by any other means. Although it is not essential that the employer relinquish all power to modify or terminate the rights of certain employees covered by the trust, it must be impossible for the trust funds to be used or diverted for purposes other than for the exclusive benefit of his employees or their beneficiaries."[2]

A plan that is amended to terminate has not, in fact, been terminated under the Code if assets of the plan remain in the plan's related trust rather than being distributed as soon as administratively feasible after the date of plan termination, regardless of whether the plan is treated as terminated under other federal law, including Title IV of the Employee Retirement Income Security Act of 1974 (ERISA). Generally, a pending determination letter application extends this date, but an Internal Revenue Service (IRS) audit of the employer does not.[3] If all plan assets are not distributed as soon as administratively feasible, the plan is an ongoing plan and must continue to satisfy the requirements of Code Section 401(a), including amendments for law changes,

to continue its qualified status. Such plan remains subject to minimum funding requirements, where applicable, and in any year in which the trust assets have not been distributed, the plan is subject to the information reporting requirements of Code Sections 6057 and 6058 (e.g., Form 5500, Annual Return/Report of Employee Benefit Plan[4]) and the actuarial reporting requirements of Code Section 6059 (Schedule SB to Form 5500). Therefore, termination of a plan generally requires that all assets be distributed, whether to pay benefits, as a transfer to a qualified replacement plan, or as a reversion to the employer, as soon as administratively feasible. Whether a distribution is made as soon as administratively feasible is to be determined under all the facts and circumstances but, generally, a distribution which is not completed within one year following the date of plan termination specified by the employer will be presumed not to have been made as soon as administratively feasible.[5]

A plan subject to termination insurance from the Pension Benefit Guaranty Corporation (PBGC) is considered terminated as of a particular date if, as of that date, it was voluntarily terminated by the plan administrator under ERISA Section 4041 or terminated by the PBGC under ERISA Section 4042. For such plans, the date of termination is determined under ERISA Section 4048. In the case of a single-employer plan terminated in a standard termination in accordance with ERISA Section 4041(b), the plan termination date is the date proposed in the notice of intent to terminate provided to: participants in the plan, beneficiaries of deceased plan participants, alternate payees under qualified domestic relations orders applicable to plan participants, and employee organizations that currently represent any group of plan participants.[6] If the plan is not subject to PBGC termination insurance, the plan is considered terminated on a particular date if, as of that date, it is voluntarily terminated by the employer or employers maintaining the plan.[7]

Exceptions to the one-year rule are limited and depend on the facts and circumstances of the plan termination. The IRS has noted, based on analogous guidance that, in order to determine the termination date for plans not subject to PBGC termination insurance, a plan is not treated as failing to meet the requirement to distribute plan assets as soon as administratively feasible to the extent that a delay in distributing plan assets is attributable to either: (1) circumstances beyond the control of the plan administrator; or (2) the period of time necessary to obtain a determination letter on the plan's qualified status upon its termination.[8]

Plans with Mandatory Employee Contributions

Excess assets in a plan with mandatory employee contributions must first be divided between the employer and the employees who made

such contributions. Before any reversion of excess assets to the employer is made, any excess assets attributable to employee contributions shall be equitably distributed to the group of participants who made such contributions or their beneficiaries (including alternate payees). Such participants include each person who, as of the plan termination date, is either—

(a) a participant under the plan; or

(b) an individual who has received, during the 3-year period ending with the termination date, a distribution from the plan of such individual's entire nonforfeitable benefit in the form of a single sum distribution or in the form of irrevocable commitments purchased by the plan from an insurer to provide such nonforfeitable benefit;

if all or part of the nonforfeitable benefit with respect to such person is, or was, attributable to participant mandatory contributions.[9]

The portion of the excess assets attributable to employee contributions is determined by multiplying the market value of the total excess assets by a fraction—

- the numerator of which is the present value of all portions of the accrued benefits with respect to participants that are derived from participant mandatory contributions (category 2 of ERISA Section 4044(a)); and

- the denominator of which is the present value of all benefits with respect to which assets are allocated under categories 2 through 6 of ERISA Section 4044(a).[10]

Plan Document Requirements

ERISA Section 4044(d) requires that a plan provide for the reversion of plan assets remaining after all liabilities of the plan to participants and their beneficiaries have been satisfied.[11] Further, "In determining the extent to which a plan provides for the distribution of plan assets to the employer, any such provision, and any amendment increasing the amount which may be distributed to the employer, shall not be treated as effective before the end of the fifth calendar year following the date of the adoption of such provision or amendment."[12] If the plan has been in effect for fewer than five years, the plan need only have provided for a reversion since the effective date of the plan to satisfy this

ERISA requirement, although terminating a plan within five years of its inception may raise plan permanency questions from the IRS that would need to be explained.[13]

DEFINITION OF REVERSION FOR PURPOSES OF THE EXCISE TAX

For purposes of determining whether an excise tax is due, a *reversion* is defined generally as "the amount of cash and the fair market value of other property received (directly or indirectly) by an employer from the qualified plan."[14] Nevertheless, there are transfers of assets from a qualified plan to the employer that are not considered to be reversions for purposes of determining whether an excise tax is due from the employer.

Exceptions for Distributions to the Employer Allowable under Code Section 401(a)(2)

Any distribution to the employer maintaining the plan that is allowable under Code Section 401(a)(2) by reason of erroneous actuarial computations or mistake of fact or by reason of the failure of the plan to initially qualify or a failure of contributions to be deductible is not considered a reversion.[15]

Erroneous Actuarial Computations

The employer sponsor is permitted to reserve the right under the terms of the plan and trust to recover at the termination of the plan, and only at such termination, any balance remaining in the trust that is due to erroneous actuarial computations during the life of the trust prior to termination. "A balance due to an 'erroneous actuarial computation' is the surplus arising because actual requirements differ from the expected requirements even though the latter were based upon previous actuarial valuations of liabilities or determinations of costs of providing pension benefits under the plan and were made by a person competent to make such determinations in accordance with reasonable assumptions as to mortality, interest, etc., and correct procedures relating to the method of funding."[16] If, however, excess assets had accumulated as a result of a change in the benefit provisions or in the eligibility requirements of the plan, the excess could not revert to the employer because such excess would not be the result of an erroneous actuarial computation.[17]

ERISA Section 403(c)(2) Exceptions

ERISA Section 403(c)(2), for which there is no parallel provision in the Code, provides for the return of contributions to the employer from

the plan, under certain circumstances, such that the amounts returned to the employer are not a reversion for purposes of the excise tax.[18] Such return of contributions to the employer from the plan are permitted under the following circumstances, if the plan document so provides:

- The contribution is made by an employer to a plan (other than a multiemployer plan) by mistake of fact and is returned to the employer within one year after payment of the contribution;

- The contribution is conditioned on initial qualification of the plan under Code Section 401 or 403(a), the plan receives an adverse determination with respect to its initial qualification, and the contribution is returned within one year after such determination, but only if the application for determination was made by the time prescribed by law for filing the employer's return for the taxable year in which the plan was adopted (or such later date as the Secretary of the Treasury may prescribe); or

- The contribution is conditioned upon its deductibility under Code Section 404 and the contribution, to the extent its deductibility is disallowed, is returned to the employer within one year after the disallowance of the deduction.[19]

Exception for Transfers from Retiree Health Account to Maintain Plan Funded Status

Transfers from a plan's Code Section 420 health benefits account or applicable life insurance account to the plan to bring a funding shortfall to zero is not a reversion of plan assets to the employer.[20]

Exception for Benefits that Could Have Been Distributed before Plan Termination

Except as provided in regulations,[21] any amount distributed from a plan to or on behalf of any employee (or his beneficiaries) is not a reversion for purposes of the excise tax if such amount could have been so distributed before termination of the plan without violating any provision of Code Section 401.[22]

Exceptions for Governmental Plans and Plans of Tax-Exempt Employers

The Code Section 4980 excise tax only applies to a reversion from a qualified plan, where *qualified plan* means any plan that satisfies the

requirements of Code Section 401(a) or 403(a) other than a governmental plan within the meaning of Code Section 414(d) or a plan maintained by an employer that has, at all times, been exempt from income tax under Subtitle A of the Internal Revenue Code.[23]

There had been a question of whether this exception applies to a plan of a tax-exempt employer which had unrelated business taxable income (UBTI). This question was resolved when a 2012 Tax Court case held that excess assets received by an organization continually exempt from tax under Code Section 501(c)(3), upon the termination of the organization's plan, was not a reversion from a qualified plan merely because the organization had paid tax on unrelated business income from time to time and that, therefore, the excise tax did not apply.[24] A 2015 IRS private letter ruling acknowledged the Tax Court's ruling, for a different organization, stating that "the existence of UBTI does not prevent Employer from having been, at all times, exempt from tax under subtitle A for purposes of section 4980(c)(1)(A)."[25]

EXCISE TAX

Upon plan termination, any *reversion* of plan assets to the employer (as defined above) is subject to an excise tax equal to 50 percent of the amount of the reversion, unless the employer either (1) provides pro-rata benefit increases under the plan being terminated, (2) establishes or maintains a *qualified replacement plan*, or (3) does both (1) and (2), in which case the excess tax is reduced to 20 percent of the amount of the reversion, provided that certain specified conditions (described below) are satisfied.[26]

The excise tax is paid by the employer maintaining the plan at the time of its termination.[27] The excise tax is due by the last day of the month following the month in which the employer reversion occurs.[28] The excise tax paid is not in lieu of any federal income taxes otherwise applicable to the reversion due to it being a return of deductible contributions the employer made to the plan prior to the plan's termination. The 50 percent excise tax does not apply to an employer in bankruptcy liquidation under Chapter 7 of Title 11 of the United States Code, or in similar proceedings under state law, as of the plan termination date and the 20 percent excise tax applies instead, without regard to whether the employer provides pro-rata benefit increases in the terminating plan or establishes or maintains a qualified replacement plan.[29]

The tax is paid with Form 5330, Return of Excise Taxes Related to Employee Benefit Plans. Interest, at the rate determined under Code Section 6621, is charged on taxes not paid by the due date, even if an

extension of time to file the tax return is granted. A penalty of 5 percent of the unpaid tax for each month or part of a month that the return is not filed by the due date, including extensions, may be assessed up to a maximum of 25 percent of the unpaid tax. This penalty will not be imposed if due to reasonable cause shown in an attachment to Form 5330 explaining the reason. Failure to pay the tax when due may result in a penalty of ½ percent of the unpaid tax for each month or part of a month the tax is not paid, up to a maximum of 25 percent of the unpaid tax. This penalty will not be imposed if the failure to pay is shown to be due to reasonable cause.[30]

QUALIFIED REPLACEMENT PLAN

If an employer establishes or maintains a qualified plan in connection with a defined benefit plan termination, the excise tax is 20 percent, rather than 50 percent, of the amount of a reversion to the employer, provided the plan satisfies the following requirements to be a qualified replacement plan (QRP).[31] For purposes of determining whether there is a QRP, the Secretary of Treasury may provide that two or more plans can be treated as one plan or that a plan of a successor employer may be taken into account.[32] The parent company of a subsidiary sponsor of both a terminated defined benefit plan and the QRP to which excess assets of the terminated plan were transferred could retain the QRP upon the sale of the subsidiary sponsor provided the plan continued to meet the requirements of a QRP.[33]

Participation Requirement

At least 95 percent of the active participants in the terminated plan who remain as employees of the employer after the plan termination must be active participants in the QRP.[34] For purposes of this participation requirement, *employer* means all employers treated as a single employer under Code Sections 414(b), (c), (m), or (o).[35] An existing plan can be a QRP and that plan can have participants other than those who participated in the terminating plan provided at least 95 percent of the active participants in the terminated plan who remain as employees of the employer after the plan termination are active participants in that plan.[36]

Asset Transfer Requirement

Prior to any reversion to the employer, a direct transfer must be made from the terminated plan to the QRP in an amount that is at least 25 percent of the maximum amount the employer could receive as a reversion (reduced by increased benefits in the terminating plan

as described in the next paragraph, if applicable).[37] The amount transferred to the QRP is not—

- Included in the gross income of the employer;
- Allowed as a deduction by the employer; or
- Treated as a reversion to the employer.

If the employer increases the accrued benefits of participants or beneficiaries under the terminating plan pursuant to an amendment to the terminating plan, which is adopted during the 60-day period ending on the plan termination date and taking effect immediately upon the plan termination date, the minimum transfer to the QRP of 25 percent of the maximum amount the employer could receive as a reversion (referenced above) is reduced by an amount equal to the present value[38] of the aggregate increases in the accrued benefits so provided to participants or beneficiaries under the terminating plan.[39] Any such increase in benefits is treated as an annual benefit for purposes of Code Section 415, but the reduction for participation or service of less than 10 years under Code Section 415(b)(5)(D) shall not apply to such increase to the extent that its nonapplication does not discriminate in favor of highly compensated employees (as defined by Code Section 414(q)). A benefit may not be increased if such an increase would result in a failure to satisfy any requirement of Code Section 401(a)(4) or 415.[40]

Allocation Requirement

If the QRP is a defined contribution plan, the amount transferred to the QRP must be allocated to the accounts of participants in the plan year in which the transfer occurs or credited to a suspense account and allocated from such account to accounts of participants no less rapidly than ratably[41] over the 7 plan-year period beginning with the year of the transfer.[42] Code Section 4980(d)(2)(C) does not specify a method for allocating amounts from the suspense account to individual participant accounts, but the plan should specify how the transferred amounts will be used such that the allocation provisions of the plan satisfy the definitely determinable requirements for profit-sharing plans.[43] Therefore, amounts from the suspense account could be allocated to individual participant accounts using an age or service weighted formula, pro rata based on participant compensation, or based on any other definitely determinable method, provided such method otherwise satisfies plan qualification requirements.[44] An amount may not be allocated to a participant if such allocation would result in a failure to satisfy any

requirement of Code Section 401(a)(4) or 415.[45] Restrictions designed to prevent discrimination in contributions in favor of highly compensated employees that are applied to participants of a QRP who are highly compensated employees would not cause such participants to cease being active participants in the QRP for purposes of the 95% participation requirement (described above).[46] Because the transferred amounts must be allocated to participant accounts, it would seem the amounts transferred could not be used to pay expenses of the QRP.

Any allocation of any amount, or income allocable thereto, to any account shall be treated as an annual addition under Code Section 415.[47] If any amount credited to a suspense account cannot be allocated to a participant before the close of the 7-plan-year period due to any limitation under Code Section 415, such amount shall be allocated to the accounts of other participants and, if any portion of such amount cannot be allocated to other participants due to any limitation under Code Section 415, such portion shall be allocated to the participant as provided in Code Section 415.[48] Any income on any amount credited to a suspense account must be allocated (after the coordination with Code Section 415 limits described in the prior sentence) to accounts of participants no less rapidly than ratably over the remainder of the period set for allocating the suspense account (the original period set being no longer than the 7-plan-year period beginning with the year of the transfer).[49]

If the QRP is terminated and any amount credited to a suspense account is not allocated as of the termination date of the QRP, such amount shall be allocated to the accounts of participants as of QRP termination date, except that any amount that cannot be allocated by reason of any limitation under Code Section 415 shall be allocated to the accounts of other participants, and if any portion of such amount cannot be allocated to other participants by reason of any limitation under Code Section 415, such portion shall be treated as an employer reversion to which the excise tax may apply.[50]

Allocation as Matching Contributions Not Permitted

Prior to the issuance of Treasury regulations under Code Section 401(m), excess assets transferred to a QRP could be used to fund matching contributions.[51] The regulations issued December 29, 2004, and effective for plan years beginning after December 31, 2005, provide that employer contributions are not matching contributions if contributed before the cash or deferred election is made or before the employee's performance of services with respect to which the elective deferrals are made (or when the cash that is subject to the election would be currently available, if earlier) or, if with respect to employee after-tax contributions, if contributed before the employee contributions are made.[52]

Subsequent private letter rulings have cited this regulation to the effect that an allocation of excess assets from a defined benefit plan termination to a defined contribution QRP generally cannot be allocated as matching contributions.[53]

PRO-RATA BENEFIT INCREASES TO AVOID 50 PERCENT EXCISE TAX

The pro-rata benefit increases provided under a terminating defined benefit plan needed for the 20 percent excise tax rate to apply to a reversion, rather than the 50 percent tax rate, must satisfy several requirements with respect to qualified participants.[54] A *qualified participant* for this purpose means an individual who is—

(a) An active participant;

(b) A participant or beneficiary in pay status as of the plan termination date;

(c) A participant not described in (a) or (b) who has a nonforfeitable right to an accrued benefit under the terminated plan as of the termination date and whose service, which was creditable under the terminated plan, terminated during the period beginning three years before the plan termination date and ending with the date on which the final distribution of assets occurs; or

(d) A beneficiary who has a nonforfeitable right to an accrued benefit under the terminated plan as of the termination and is a beneficiary of a participant described in (c).[55]

An amendment to the terminating plan to provide pro-rata benefit increases must be adopted in connection with the plan termination and take effect immediately on the plan termination date. The amendment must provide pro-rata increases in the accrued benefits of all qualified participants which have an aggregate present value not less than 20 percent of the maximum amount the employer could receive as an employer reversion without regard to such amendment or a transfer of excess assets to a QRP. The pro-rata increase must be an increase in the present value of the accrued benefit of each qualified participant in an amount that is in the same ratio to the aggregate present value determined under the prior sentence as the ratio of the present value of such participant's accrued benefit (determined without regard to the amendment providing the pro-rata increases or a transfer of excess assets to a QRP) is to

the aggregate present value of accrued benefits of the terminated plan. Notwithstanding the preceding sentence, the aggregate increases in the present value of the accrued benefits of qualified individuals who are not active participants must not exceed 40 percent of the aggregate present value equal to 20 percent of the maximum amount the employer could receive as a reversion.[56] Any increase in benefits described in this paragraph is treated as an annual benefit for purposes of Code Section 415, but the reduction for participation or service of less than 10 years under Code Section 415(b)(5)(D) shall not apply to such increase to the extent that its nonapplication does not discriminate in favor of highly compensated employees (as defined by Code Section 414(q)). A benefit may not be increased if such an increase would result in a failure to satisfy any requirement of Code Section 401(a)(4) or 415.[57]

IN CONCLUSION

This article is an attempt to bring together in one place much of the available guidance regarding the return of defined benefit plan excess assets to the plan sponsor and the applicable reversion excise tax, if any. According to the U.S. Bureau of Labor Statistics, Employee Benefits Survey, as of March 2019, 14 percent of all private industry workers participating in a defined benefit plan participated in a plan in which all benefits accruals were frozen, and 24 percent participated in a plan closed to new participants.[58] The funded status of defined benefit plans has recently been improving. This is leading many employers to consider terminating their frozen and closed plans, as well as active plans, before market changes can return the plans to funding shortfalls of the past decade, when employers needed to fund the shortfalls over a multiyear amortization period for annual funding shortfalls. Some of these plans may end up with excess assets upon termination, with plan sponsors looking at what to do with those excess assets left after paying plan benefits and liabilities and how to minimize excise taxes on any reversion to the employer.

The Code is reasonably clear on the basic requirements around defined benefit plan reversions and application of the reversion excise tax, but there are no regulations under Code Section 4980 providing guidance on the less clear provisions. A handful of revenue rulings and court cases provide some additional guidance, but most of the additional guidance available comes in the form of private letter rulings, which are directed solely to the taxpayers who request them and may not be cited or relied upon as precedent by other taxpayers or by IRS personnel. Employers with facts and circumstances seemingly outside

the parameters of the Code and other formal guidance, or who wish to obtain more assurance that their actions will not violate Code requirements, should consider obtaining their own private letter rulings. The procedures and user fees for obtaining a letter ruling are published annually in the first revenue procedure of each calendar year.[59]

Employers considering terminating a defined benefit plan should involve their actuaries, legal counsel, retirement plan consultants, and other qualified advisors to assist in the decision of whether and when to terminate the plan and, if there will likely be excess assets upon the plan's termination, to advise on what to do with those excess assets and whether to seek input from the IRS and Treasury in the form of a private letter ruling or otherwise.

NOTES

1. Code § 401(a)(2) also provides the following exception for multiemployer plans, but this article does not consider multiemployer plans: "(but this paragraph shall not be construed, in the case of a multiemployer plan, to prohibit the return of a contribution within 6 months after the plan administrator determines that the contribution was made by a mistake of fact or law (other than a mistake relating to whether the plan is described in section 401(a) or the trust which is part of such plan is exempt from taxation under section 501(a), or the return of any withdrawal liability payment determined to be an overpayment within 6 months of such determination));"
2. *See* Treas. Reg. § 1.401-2(a)(2).
3. *See* Internal Revenue Manual, Employee Plans Guidelines on Plan Terminations § 7.12.1.8 (3) on the IRS website at: *https://www.irs.gov/irm/part7/irm_07-012-001#idm140573868535712.*
4. Also includes Form 8955-SSA, Annual Registration Statement Identifying Separated Participants with Deferred Vested Benefits and the related Individual statement to separated participants with deferred vested retirement benefits, and Form 5310-A, Notice of Plan Merger or Consolidation, Spinoff, or Transfer of Plan Assets or Liabilities; Notice of Qualified Separate Lines of Business. *See* IRS guide to Retirement Plan Reporting and Disclosure Requirements.
5. *See* Rev. Rul. 89-87.
6. *See* ERISA §§ 4048(a)(1) & 4041(a)(2) and ERISA §§ 4001.2 & 4041.23.
7. *See* Treas. Reg. § 1.411(d)-2(c).
8. *See* PLR 201626003. The analogous guidance referenced is Treas. Reg. § 1.430(a)-1(f)(5)(ii)(B). This private letter ruling (PLR) found that: (1) retaining assets in the plan trust sufficient to cover the maximum estimated potential contingent liability of the plan as defendant in a lawsuit, after satisfying all benefit liabilities and transferring at least 25% of the remaining assets to a replacement plan, would not be treated as failing to satisfy the requirement to distribute plan assets as soon as administratively feasible, provided that any assets remaining in the trust after the contingent liability is resolved are transferred to the replacement plan as soon as administratively feasible in accordance with a resolution adopted by the company; (2) the replacement plan is a QRP, having satisfied the other requirements to be a QRP; and (3) neither the initially transferred excess assets nor the later transferred excess assets constitute a reversion

to the employer. A private letter ruling (PLR) is based on the specific facts and circumstances presented and applies only to the taxpayer who requested it. A PLR cannot be used or cited as precedent. Nevertheless, a PLR can be indicative of the IRS position on an issue as of the point in time the PLR was issued.

9. *See* ERISA § 4044(d)(3)(A) & (C).
10. *See* ERISA § 4044(d)(3)(B). *See also* PLR 9645029. The six categories are:
    1. That portion of each individual's accrued benefit which is derived from the participant's contributions to the plan which were not mandatory contributions.
    2. That portion of each individual's accrued benefit which is derived from the participant's mandatory contributions.
    3. (A) In the case of the benefit of a participant or beneficiary payable as an annuity which was in pay status as of the beginning of the 3-year period ending on the termination date of the plan, to each such benefit, based on the provisions of the plan (as in effect during the 5-year period ending on such date) under which such benefit would be the least (the lowest benefit in pay status during a 3-year period shall be considered the benefit in pay status for such period for purposes of (A)); and

       (B) in the case of a participant's or beneficiary's benefit payable as an annuity (other than a benefit described in (A)) which would have been in pay status as of the beginning of such 3-year period if the participant had retired prior to the beginning of the 3-year period and if his benefits had commenced (in the normal form of annuity under the plan) as of the beginning of such period, to each such benefit based on the provisions of the plan (as in effect during the 5-year period ending on such date) under which such benefit would be the least.
    4. (a) All other benefits (if any) of individuals under the plan guaranteed under this subchapter (determined without regard to ERISA § 4022B(a)); and

       (b) the additional benefits (if any) which would be determined under (a) if ERISA § 4022(b)(5)(B) did not apply. For purposes of this category 4, ERISA § 4021 shall be applied without regard to ERISA § 4021(c).
    5. All other nonforfeitable benefits under the plan.
    6. All other benefits under the plan.
11. *See* ERISA § 4044(d)(1).
12. *See* ERISA § 4044(d)(2)(A).
13. *See* ERISA § 4044(d)(2)(B) and Internal Revenue Manual Part 7, § 7.12.1.3 (2-16-2017) at the IRS website: *https://www.irs.gov/irm/part7/irm_07-012-001#idm140573867973920*.
14. *See* Code § 4980(c)(2)(A).
15. *See* Code § 4980(c)(2)(B)(ii)(II) & (III). Code § 4980(c)(2)(B)(ii)(I) provides an exception, in the case of a multiemployer plan, by reason of mistakes of law or fact or the return of any withdrawal liability payment, but this article does not consider multiemployer plans. Exceptions were also permitted for amounts transferred to certain employee stock ownership plans after March 31, 1985 and before January 1, 1989. *See* Code § 4980(c)(3).
16. *See* Treas. Reg. § 1.401-2(b)(1).
17. *See* example in Treas. Reg. § 1.401-2(b)(1). *See, e.g.,* PLR 201424032 (employer inadvertently failed to include some assets when determining contribution, which resulted in surplus being returned) and PLR 201430025 (actuarial calculations resulted in larger contribution than

needed to fully fund the plan upon termination and insurer refunded portion of annuity purchase premiums due to revised participant data after initial bid, resulting in funds returned to employer without being a reversion). *But see* PLR 201208043 in which request for a disallowance of deduction and return of contribution was denied because there was no indication that the determination of the maximum deductible contribution communicated in the actuarial valuation report involved any mistake in fact or any good faith mistake in determining the deductibility of the contribution or that the employer contribution made to the plan was attributable to any good faith mistake in reliance on the plan's actuarial valuation report.

18. *See* Rev. Rul. 91-4 and Code § 4980(c)(2)(B)(ii). Although Rev. Rul. 91-4 refers to the amounts returned to the employer from the plan as "reversions," Code § 4980(c)(2)(B)(ii) excludes such amounts from the definition of reversion for purposes of the excise tax, as confirmed by IRS private letter rulings. *See, e.g.,* PLRs 200851045, 201228055, 201430025, and 201839010.
19. *See* ERISA § 403(c)(2) and Rev. Rul. 91-4. ERISA § 403(c)(2)(A)(ii) provides an exception specific to multiemployer plans, but this article does not consider multiemployer plans.
20. *See* Code §§ 4980(c)(2)(B)(iii) and 420(f)(2)(B)(ii)(II). The shortfall is the amount by which 120 percent of the sum of the funding target and the target normal cost determined under Code § 430 for the plan year exceeds the lesser of (1) the fair market value of the plan's assets (reduced by the prefunding balance and funding standard carryover balance determined under Code § 430(f)) or (2) the value of plan assets as determined under Code § 430(g)(3) after reduction under Code § 430(f). The author is not aware of any additional guidance on Code § 4980(c)(2)(B)(iii).
21. No regulations have been issued under Code § 4980.
22. *See* Code § 4980(c)(2)(B)(i). "[O]ver-funded pension benefits given to the pension beneficiaries are not assessed a reversion tax." *See* United States v. Juvenile Shoe Corp. of Am., 99 F.3d 898, 902 fn. 7 (8th Cir. 1996). Where an employer transferred excess assets from a plan termination to its profit-sharing plan after holding the funds in its own accounts for over 2 months, the court found that the distribution to the employer did not fall within the exception set out in Code § 4980(c)(2)(B)(i). "A review of 26 U.S.C. § 401, which establishes what constitutes a qualified plan, reveals that it makes no provision for the withdrawal of funds by the employer to be held in its own accounts until it decides to contribute [to] another plan established for its employees. Section 401 does make provision for different forms of pre-termination disbursements on behalf of employees, however, the section makes clear that disbursements not following the strict requirements of its provisions render the plan non-qualified. ... There is nothing within the terms of section 401 to support an 'indirect transfer' from a terminated plan to a new plan." *See* S. Aluminum Castings Co. V. United States, 778 F. Supp. 1200, 1201 (S.D. Ala. 1991).
23. *See* Code § 4980(c)(1).
24. *See* Research Corp. v. Comm'r., 138 T.C. 192 (2012).
25. *See* PLR 201538022.
26. *See* Code § 4980(d)(1). Technically, the excise tax is 20% but is increased to 50% unless the employer either provides the pro rata benefit increases, establishes or maintains a qualified replacement plan, or does both. *See* Code § 4980(a). Code § 4980(d) was added later.
27. *See* Code § 4980(b).

28. *See* Code § 4980(c)(4).
29. *See* Code § 4980(d)(6). This section should not be read to include bankruptcy under Chapter 11. *See* IRS Chief Counsel Advice 200226001 (released June 6, 2002), which may not be cited as precedent.
30. *See* Instructions for Form 5330 available at the irs.gov website.
31. *See* Code § 4980(d)(2).
32. *See* Code § 4980(d)(5)(D). No regulations to this effect have been issued. PLR 201935003, however, found that a bargaining 401(k) plan and a nonbargaining 401(k) plan of the employer together may constitute a QRP, assuming other requirements to be a QRP are satisfied. *See also* PLRs 9645029 and 9803027.
33. *See* PLR 201143034.
34. *See* Code § 4980(d)(2)(A). The author is not aware of any guidance regarding how the 95% rule would apply in the case of a terminating plan with no active employees. Some have argued, hypothetically, that in such case the excess assets can still be transferred to a replacement plan that satisfies the requirements to be a QRP. Obtaining a PLR may be advisable in such instance.
35. *See* Code § 4980(d)(5)(E).
36. *See, e.g.,* PLR 201935003.
37. Rev. Rul. 2003-85 provided a significant departure from the previous IRS position, as taken in prior private letter rulings (including rulings issued as recently as 2002). Under the IRS's prior position, the exclusion from excise and income taxes was limited to an amount equal to 25% of the excess assets generated upon plan termination. Any amounts transferred in excess of this 25% limitation were effectively considered a part of the reversion to the employer and were subject to subject to the 20% excise tax under Code § 4980, treated as income for federal tax purposes and subject to deductible limits as a plan contribution. *See, e.g.,* PLRs 9837036, 200221049, and 200252094. The revenue ruling essentially interprets "equal to 25%" in Code § 4980(d)(2)(i) as "at least 25%."
38. Present value shall be determined as of the plan termination date and on the same basis as liabilities of the plan are determined on termination. *See* Code § 4980(d)(5)(B).
39. *See* Code § 4980(d)(2)(B).
40. *See* Code § 4980(d)(4). Although not entirely clear, it appears that the "Reallocation of Increase" language of Code § 4980(d)(5)(C) is intended to mean that a reduction in a participant's benefit increase due to this sentence of the article or the prior two sentences of the article should be allocated to the remaining participants on the same basis as other benefit increases and the pro rata requirement will still be deemed satisfied.
41. The question as to what "ratably" means has been put to the author. The facts in the majority of all of the PLRs on transferring excess assets to a suspense account in a QRP either merely restate the rule that allocations will be no less rapidly than ratably over the 7-year period (s*ee, e.g.,* PLRs 9302027, 200221049, 200344025, 201143034, 201147032, 201626003, and 201935003) or provide for contributions to participant accounts of one-seventh of the transferred assets in first of 7 years, one-sixth in the second, one-fifth in the third, one-fourth in the fourth, one-third in the fifth, one-half in the sixth, and the balance in the seventh year (s*ee, e.g.,* PLRs 200107038, 200109052, 200227040, 200836034, and 200836035).

42. *See* Code § 4980(d)(2)(C)(i). The question has been put to the author as to what the result would be if the QRP failed to allocate the entire amount transferred over the 7-year period. The answer may be that the replacement defined contribution plan would fail to be a QRP and, therefore, the transferred assets become treated as a reversion, subject to the 50% excise tax rate along with any reversion to the employer that had been subject to the 20% excise tax rate (based on the replacement plan originally being treated as a QRP). The author is not aware of any guidance directly addressing this question. PLRs 200836034 and 200836035, however, note that a portion of the transferred amount may remain as a result of the application of the limitations under Code § 415 at the end of the 7-year period and be transferred to the employer as a reversion, and that such reversion will not cause the replacement plan to fail to be a QRP, provided the amount thus received by the employer is less than 75% of the amount that could have been received initially as a reversion by the employer (i.e., the minimum 25% required transfer is maintained). This suggests that merely failing to ratably allocate the transferred assets over the 7-year period, as opposed to being unable to do so because of Code § 415 limits, would result in the replacement plan failing to be a QRP.
43. *See, e.g.*, PLRs 200212035, 200836035, and 201147032. *See, also*, Treas. Reg. § 1.401-1(b)(1)(ii) as to definitely determinable requirements for profit-sharing plans.
44. *See, e.g.*, PLR 200212035, which allocated based on a service weighted formula.
45. *See* Code § 4980(d)(4)(A). Although it is not entirely clear, Code § 4980(d)(5)(C) seems to say that, if allocations are reduced due to any requirement under Code § 401(a)(4) or 415, "the amount of such reduction shall be allocated to the remaining participants on the same basis as other increases (and shall be treated as meeting any allocation requirement of this subsection)," except as provided in Code § 4980(d)(2)(C), the provisions of which are described in this article's subsection entitled "Allocation Requirement."
46. *See, e.g.*, PLR 201147032.
47. *See* Code § 4980(d)(4)(B).
48. *See* Code § 4980(d)(2)(C)(ii). Unfortunately, the last clause of Code § 4980(d)(2)(C)(ii)(II) is not entirely clear as to what amount "shall be allocated to the participant as provided in section 415." PLR 200109052, however, indicates that this amount is the portion that cannot be allocated to other participants due to any limitation under Code Section 415.
49. *See* Code § 4980(d)(2)(C)(iii).
50. *See* Code § 4980(d)(2)(C)(iv).
51. *See, e.g.*, PLRs 9252035 and 9302027.
52. *See* Treas. Reg. § 1.401(m)-1(a)(2)(iii). The preamble to the regulations expressly noted that "employer contributions made under the facts in Notice 2002-48 would not be taken into account under the ACP test and would not satisfy any plan requirement to provide matching contributions." It has been suggested that the wording of the regulations may leave open the ability to fund year-end matching contributions in the QRP with respect to elective deferrals or employee contributions already made for the plan year before the transfer of excess assets is made. Obtaining a PLR before proceeding with this suggestion seems advisable.
53. *See, e.g.*, PLRs 200836034, 200836035, and 201147032.
54. *See* Code § 4980(d)(3). Note that, unlike the requirement of this section, the increase in benefits described in Code § 4980(d)(B)(ii) need not be pro rata increases.

55. *See* Code § 4980(d)(5)(A).
56. *See* Code § 4980(d)(3). Present value is determined as of the plan termination date and on the same basis as liabilities of the plan are determined on termination. *See* Code § 4980(d)(5)(B).
57. *See* Code § 4980(d)(4).
58. *See* Table 5. Defined benefit retirement plans: Open, soft and hard frozen plans, private industry workers, March 2019 on the Bureau of Labor Statistics website at: *https://www.bls.gov/ncs/ebs/benefits/2019/benefits_retirement.htm*
59. *See, e.g.,* Rev. Proc. 2020-1.