EP DETERMINATIONS
QUALITY ASSURANCE BULLETIN

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Processing Determination Letter Applications Involving Plan Mergers, Consolidations, Spinoffs, or Transfers of Plan Assets or Liabilities

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The purpose of this bulletin is to provide guidance to screeners and determination specialists who encounter requests for determination letters with respect to plans that have been involved in a merger or consolidation, spinoff or transfer of assets. Plan mergers require special considerations for determination review. These generally include a determination as to the timely amendments of the merged plans, protected benefits and vesting.

I. Background

While we do not rule on mergers or consolidations, spinoffs or transfers, we frequently encounter determination letter applications for ongoing or terminated plans that were previously involved in mergers, etc.

Section 401(a)(12) of the Code provides that a qualified plan must provide that if it merges or consolidates with, or transfers assets or liabilities to, any other plan after September 2, 1974, each participant will (if the plan then terminated) receive a benefit immediately after the merger, etc., which is equal to or greater than the benefit the participant was entitled to immediately before the merger, etc., (if the plan had then terminated).

Section 414(l) of the Code provides, in part, that a plan will fail to be qualified unless each participant in the plan would receive a benefit immediately after the merger, consolidation, or transfer which is equal to or greater than the benefit he would have been entitled to receive immediately before the merger, consolidation, or transfer (if the plan then terminated).

Section 3.01 of Rev. Proc. 2003-6, which is revised annually, provides that Form 5310–A, Notice of Plan Merger, Consolidation, Spinoff or Transfer of Plan Assets or Liabilities—Notice of Qualified Separate Lines of Business, generally must be filed not less than 30 days before the merger, consolidation or transfer of assets and liabilities. The filing of Form 5310–A will not result in the issuance of a determination letter.

Section 1.411(d)-2(b)(2) of the Regulations contains a special rule providing that if a defined benefit plan ceases or decreases future benefit accruals under the plan, a partial termination shall be deemed to occur if, as a result of such cessation or decrease, a potential reversion to the employer maintaining the plan is created or increased.

Section 1.401(a)-2(b) provides that a plan may provide that upon the plan's termination assets held in a section 415 suspense account may revert to the employer.

Section 1.415-6(b)(6) describes how amounts in a section 415 suspense account must be allocated to participants before any amount in the section 415 suspense account may revert to the employer on plan termination.

Rev. Rul. 80-155, 1980-1 C.B. 84, provides that a profit-sharing, stock bonus, or money purchase pension plan (i.e., a defined contribution plan) will not satisfy plan qualification requirements unless all funds are allocated to participants' accounts under the plan in accordance with a definite formula (although certain exceptions are allowed, such as the use of a suspense account in accordance with the requirements of section 415 of the Code).

II. Definitions

a). The term "merger" or "consolidation" means the combining of two or more plans into a single plan. A merger or consolidation will not occur merely because one or more corporations undergo a reorganization (whether or not taxable). Furthermore, a merger or consolidation will not occur if two plans are not combined into a single plan, such as by using one trust which limits the availability of assets of one plan to provide benefits to participants and beneficiaries of only that plan. Treas. Reg. 1.414(l)-1(b)(2)

Example – After acquiring ABC Corporation, EFG Corporation amends ABC Corporation's defined benefit plan to provide the same benefits as EFG Corporation's defined benefit plan. The assets of the ABC Corporation Defined Benefit Plan are transferred to the trust containing the assets of the EFG Corporation's defined benefit plan in such a manner that the assets of each plan are separately accounted for, and are not available to pay benefits of the other plan. Because the assets are not available to pay benefits of the other plan, there are still two plans and a merger has not occurred. As a result, Section 414(l) does not apply. Treas. Reg. 1.414(l)-1(c)(ii)

b). The term "spinoff" means the splitting of a single plan into two or more plans. Treas. Reg. 1.414(l)-1(b)(4)

c). A "transfer of assets or liabilities" occurs when there is a diminution of assets or liabilities with respect to one plan and the acquisition of these assets or the assumption of these liabilities by another plan. Treas. Reg. 1.414(l)-1(b)(3)

III. Effective Date

The actual date of a merger or spinoff shall be determined on the basis of the facts and circumstances of the particular situation. For purposes of this determination, the following factors, none of which is necessarily controlling, are relevant:

- The date on which the affected employees stop accruing benefits under one plan and begin coverage and benefit accruals under another plan.
- The date as of which the amount of assets to be eventually transferred is calculated.
- If the merger or spinoff agreement provides that interest is to accrue from a certain date to the date of actual transfer, the date from which such interest will accrue.

Treas. Reg. 1.414(l)-1(b)(11)

The importance of the effective date cannot be overstated because IRC 6058(b) requires plan administrators to file a report with the IRS not less than 30 days before a merger, consolidation or transfer of assets or liabilities from one plan to another. Form 5310-A is used for this purpose. Forms 5310-A are processed at the Covington, KY submission processing center and, in accordance with Rev. Proc. 2003-6, no determination letter is issued.

IRC section 6652(e) provides a penalty of $25 per day not to exceed $15,000 for failure to comply with the Form 5310-A filing requirement.

IV. Determination Requirements

a). Prior Qualification – As part of our review of determination letter applications, we attempt to confirm the extent to which a plan has been amended for prior legislation, including, but not necessarily limited to the Tax Reform Act of 1986 (TRA '86). Copies of prior favorable determination letters should be secured for all of the plans involved in a merger, not just the submitted plan. This is necessary because if a merged plan had not been timely amended, the existing trust would contain assets from a non-qualified plan, which would cause the merged plan to be non-qualified. See QAS Bulletin 2000-2, revised 7/18/2001 for additional guidance.

[NOTE: See the Frequently Asked Questions attached to this bulletin for merged plans amending to comply with GUST during their remedial amendment period.]

b). Protected Benefits – IRC sections 401(a)(12) and 401(l) provide that participants must be entitled to benefits after the merger or transfer that are equal to or greater than the benefits prior to the merger or transfer on a plan termination basis. IRC section 411(d)(6) precludes the reduction of plan benefits by amendment. Rev. Rul. 94-76, I.R.B. 1994-50, addresses the issue of the character of benefits after the transfer. It provides that transferred benefits retain the character of the transferor plan. It holds that in the case of assets transferred from a money purchase plan to a profit sharing plan, the profit sharing plan must remain subject to the restrictions on distributions applicable to the qualified money purchase pension plan. If the profit sharing plan permits limited restricted distributions, the application of these distributions to the accrued benefits transferred from the money purchase plan causes the merged plan to fail to satisfy IRC 401(a).

Mergers or transfers cannot eliminate a protected benefit. If two plans are merged, or the assets of one plan are transferred in a direct trustee-to-trustee transfer to another plan, the merged plan or the transferee plan must continue to protect any optional benefit available with respect to the transferred benefits. The defined benefit character or defined contribution character of benefits being transferred or merged into another plan is protected by IRC 411(d)(6). The defined benefit feature of an employee's accrued benefit under a defined benefit plan is a protected benefit. Similarly, the separate account feature of a participant's account balance in a defined contribution plan is a protected benefit. The employer cannot eliminate these protected benefits by merging or transferring a defined benefit plan into a defined contribution plan or vice versa, unless the transaction is an elective transfer of distributable benefits or a rollover. I.T Regs. 1.411(d)-4, Q&A-3 (a)&(b)

Specialists should carefully inspect the merged plan to ensure accounts are properly segregated, vested and that the plan properly provides for distribution of benefits.

V. Spinoff/Termination and Termination/Reestablishment

Pursuant to IRM Section 7.12.1.10, Employee Plans Guidelines- Plan Terminations, Implementation Guidelines for Termination of Defined Benefit Pension Plans were issued to provide that any attempt to recover surplus assets in a spinoff/termination would be treated as a diversion of assets for a purpose other than the exclusive benefit of employees and their beneficiaries unless certain conditions are met.

Generally, the Implementation Guidelines apply to terminations that occur as part of so-called "termination/reestablishment" transactions and "spinoff/termination" transactions.

a). Under a termination/reestablishment, an employer typically terminates an overfunded defined benefit plan, receives the excess assets, and then establishes a new defined benefit plan covering the active employees.

b). Under a typical "spinoff/termination" transaction, an employer

- (i) Splits an overfunded defined benefit plan into two defined benefit plans, one for its active employees and one covering its retirees,
- (ii) Allocates the excess assets to the plan covering the retirees,
- (iii) Terminates the retirees' plan and receives the excess assets, and
- (iv) Continues to maintain the defined benefit plan for the active employees after the transaction.

IRC 414(1)(2) essentially provides that in the case of a spinoff termination (or other similar transaction) involving defined benefit plans within a controlled group; excess assets must be allocated proportionately among spunoff plans. IRC 414(1)(2) is generally applicable to transactions occurring after 7/26/88.

If IRC 414(1)(2) and the Implementation Guidelines are not satisfied, neither the terminated nor the ongoing portions of the plan shall be considered qualified. Further, an employer statement that a particular vesting schedule or benefit level will be provided in a future plan is not sufficient to give the employees an enforceable right under Title I of ERISA. Consequently, determination letter requests for the ongoing and terminated plans must be submitted simultaneously.

The Implementation Guidelines generally provide that a bona fide termination of a defined benefit plan will be recognized as having occurred under either a termination/reestablishment or spinoff/termination transaction only if certain conditions are satisfied. The conditions are designed within the confines of existing administrative authority, to protect participants with respect to both their past and future benefits without also discouraging employers from maintaining defined benefit plans.

In the event a specialist encounters a determination letter request involving a defined benefit plan where a "termination/reestablishment" or "spinoff/termination" has occurred, the case should be processed in accordance with the Implementation Guidelines. The Implementation Guidelines are specific instructions.

VI. Rev. Rul. 2002-42 Considerations

Rev. Rul. 2002-42, I.R.B. 2002-28, amplifies Rev. Rul. 94-76 to provide, under § 414(l), the transfer of assets and liabilities from a money purchase pension plan to a profit-sharing plan is considered a spinoff of those assets and liabilities from the money purchase pension plan and a merger of those assets and liabilities with the assets and liabilities of the profit-sharing plan. The merger does not divest the assets and liabilities of the money purchase pension plan of their attributes as money purchase pension plan assets and liabilities. For example, the vesting schedule under the money purchase pension plan must be maintained under the profit sharing plan, and the money purchase pension distribution requirements must be preserved. Lastly, the survivor annuity requirements apply to all accrued benefits held for a participant with respect to whom the plan is a transferee plan unless there is an acceptable separate accounting between the accrued benefits attributable to the transferred assets and liabilities and all other benefits under the profit sharing plan. See, §1.401(a)-20, Q&A-5 (b) for a description of an acceptable method of separate accounting.

Rev. Rul. 2002-42, I.R.B. 2002-28, holds that a merger or conversion of a money purchase pension plan into a profit sharing plan does not result in a partial termination of the money purchase pension plan under IRC 411(d)(3) of the Code. Therefore, full vesting is not required.

CAUTION- A money purchase plan that provides that forfeitures will only be used to reduce future employer contributions must be amended prior to the conversion to provide that forfeitures will be reallocated to participants' accounts in accordance with a definite formula. Such amounts may not revert back to the employer but must be reallocated. In the event such amounts revert back to the employer the plan may be disqualified under Code section 401(a)(2).

VII. Enforcement Follow-up

Pursuant to IRM 7.11.1.3.8, enforcement follow-up should be considered in the case of a merger, consolidation, or transfer of assets or liabilities with respect to a Form 5310-A, if any irregularities with regard to employee benefits are noted.

If the information accompanying an amendment reveals that the plan no longer qualifies (for reasons other than the amendment itself), submit Form 5666, TE/GE Referral Information Report, for enforcement follow-up.

8. Frequently Asked Questions

a). When two or more plans are merged, how many Form 5300 Applications are necessary?

Only one Form 5300 application needs to be submitted for the 'surviving plan.'

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b). If there are two plans that are being merged together, is it necessary to have both plans separately amended for new tax law prior to the plan merger?

It is the position of the Service that it is sufficient for only the ´surviving plan´ to be amended as long as its amendments are written to also retroactively amend the now merged plan to comply with the new tax law requirements. A favorable determination letter for the surviving plan may be relied upon with respect to whether the merged plans were timely and correctly amended for new tax law.

With respect to current law, if two or more plans are merged prior to the end of each plan's GUST remedial amendment period, the plans may be amended to satisfy the GUST requirements in either of two ways:

1. Each plan can be separately amended for GUST prior to the merger; or

2. The requirement to amend for GUST can be satisfied through the surviving plan. In this instance, the GUST amendments must be adopted within the GUST remedial amendment period of **the surviving plan and the merged plan(s) (see below)**, and the appropriate amendments must apply to each of the plans that have been merged into the survivor. Thus, some of the amendments to the surviving plan may apply to one or more of the merged plans and not to others, or may apply at different times to each of the merged plans. This would be necessary, for example, if different choices or elections were made in the operation of the merged plans prior to the merger.

   For example, if the merged plan provided for a QJSA (an IRC 411(d)(6) - protected benefit) while the surviving plan did not, the surviving plan must be amended to preserve this option for benefits accrued under the merged plan. The QJSA provisions of the surviving plan should also apply to the merged plan to the extent necessary to allow the plan to comply with current law prior to its merger into the surviving plan.

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c). What is the controlling date for timely adoption for GUST of merging/surviving plans?

If only the surviving plan is amended, the GUST amendments must be adopted within the GUST remedial amendment period of the surviving plan ***and each merging plan***. Otherwise, **each plan must be amended separately for GUST prior to the close of its GUST remedial amendment period**.

d). At the time of merger, what should be the qualification status of the merging plans?

Merging plans must have been timely amended for all TRA 86 requirements, including IRC 401(a)(31) and 401(a)(17).

e). What plan documents of the merging plans, if any, should be included in the GUST application for the surviving plan?

For each plan merged out of existence, the latest determination letter received by the plan sponsor with, if necessary, copies of the signed and dated amendments for IRC 401(a)(31) and 401(a)(17), plus a signed and dated copy of the plan document currently in effect. Submission of these documents will expedite the determination process.