REPORT #615

TAX SECTION

New York State Bar Association

Committee on Employee Benefits

REPORT ON THE "SAME DESK" RULE

June 12, 1989

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TAX SECTION

New York State Bar Association

June 12, 1989

The Honorable Michael J. Murphy
Acting Commissioner of Internal
Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Dear Michael:

Enclosed is a Report on the "Same Desk" Rule by our Committee on Employee Benefits. The principal draftsman of this Report is Kenneth C. Edgar, Jr.

The Report was prepared in response to Private Letter Ruling 8614060. While the Report reaches conclusions that are not fundamentally opposed to the conclusions reached in the private letter ruling, the Report is based on a different analysis that supports exceptions for de minimis amounts of accrued benefits and for elective distributions from fully funded plans where transferred employees are fully vested and the seller does not transfer pension assets and liabilities to the buyer.

The Report recommends that the same desk rule should generally apply for purposes of Section 401, but that the Service can and should make those exceptions.

Sincerely,

Wm. L. Burke

WLB/JAPP
Enclosure
4346r

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Tax Report #615

June 12, 1989

NEW YORK STATE BAR ASSOCIATION

TAX SECTION

Committee on Employee Benefits-[1]/

REPORT ON THE "SAME DESK" RULE

In 1986 the Internal Revenue Service (the "Service") issued Private Letter Ruling 8614060 which holds that in the context of a disposition of a business, a participant in a defined benefit plan maintained by the selling company who becomes employed by the purchaser (referred to as a "transferred employee" in this Report), in the same job, has not "retired" within the meaning of Treasury Regulation § 1.401-1(b)(1)(i) so as to permit such participant to begin to receive benefits under the selling company's plan. This holding is known as the "same desk" rule.

The Committee filed a preliminary comment on the same desk rule in a letter dated April 15, 1988 to Martin L. Slate, Esq., of the Internal Revenue Service. The purpose of this Report is to explore the ramifications of, and to make recommendations with regard to, the same desk rule as it applies to various corporate transactions which may affect an employee's status as a participant in a pension plan of the

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[1]/ The principal author of this report is Kenneth C. Edgar, Jr. Helpful comments were received from Richard Alpern, Stanley Baum, William Burke, Carol Buckmann, Barbara Klippert, Robert Stokes, Mark Vogel and various other members of the Committee. We especially wish to thank Kathleen L. Roin for her assistance in preparing this report.

seller.[2]/ Another important aspect of our Report deals with the effective date of any guidance issued by the Service in this area.

Summary and Recommendations

Any assessment of the “same desk” rule should be made with the objectives of achieving uniformity of application of related tax provisions unless strong policy reasons dictate divergences; treatment in the same fashion of transactions having a similar effect on the employees involved, regardless of how structured; ease of interpretation and administration; and fairness.

The same desk rule appears to have developed with little explicit analysis and arguably an implicit assumption that the policy behind other provisions of the Internal Revenue Code (such as Section 402) apply equally to Section 401 in this respect. We believe, however, that the question must be analyzed separately, and that such analysis should focus on what happens to the plan assets and liabilities in the transaction rather than, for example, whether the corporate transaction is structured as an asset or stock acquisition.

So analyzed, the same desk rule should apply in the Section 401 context without exception where the pension plan assets and liabilities are transferred with the employee,

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[2]/ As used in this Report the term "seller" means the controlled group (within the meaning of Code Section 414(b),(c),(m) and (o)) which is selling a particular business segment and the term "purchaser" means the controlled group of which that business segment is a part after the transaction.

whether by reason of transfer of an entire pension plan or by way of a spinoff of the appropriate assets and liabilities. Where the assets and liabilities remain with the seller, the same rationale applies in principle but admits of exceptions for payouts of _de minimis_ accrued benefits and elective payouts in accordance with plan terms where the employee's rights are protected by fully vesting the employee first. Thus, while we are not fundamentally opposed to the Service's conclusions in PLR 8614060, we reach that result by a different analysis that allows for exceptions that we believe the Service can and should approve.

We also believe that in light of the lack of clear Congressional or regulatory guidance in this area, any new rules or clarifications should be applied only prospectively with a transition period allowed for plans to be amended to comply with the new rules.

Guiding Objectives

In examining the same desk rule as applicable to pension plans, we have drawn a distinction between: (i) an employee's “retirement” where we believe each employee should be accorded the same treatment, regardless of the form of a corporate transaction and regardless of whether or not pension assets have been transferred to a purchaser, and (ii) the ability of a plan sponsor who has retained pension assets to pay out benefits to former employees who are now working for a different controlled group.

In addressing the same desk rule we have attempted to keep several goals in mind. Our first is uniformity of, application of related provisions of the Internal Revenue Code of 1986 as amended (the “Code”), unless there is a strong policy reason to vary such treatment. For example, there is much existing statutory and regulatory authority currently applicable to pension plan participants in transactions. Code Sections 401, 402, 410, 411 and 414, as discussed below, already contain provisions relating to the treatment of participants in a seller's pension plan who are affected by transactions, and various ancillary authority exists. The interpretation (or revocation) of the same desk rule should not, if possible, be inconsistent with principles already expressed in the foregoing Code sections and the regulations thereunder.

Another goal is to treat in the same fashion transactions which have a similar effect on the employee, regardless of how they are structured by the seller and the purchaser. For example, one of our guiding principles is chat a participant's pension entitlement should not be affected by whether a transaction is structured as a sale of assets or a sale of stock. Rather, emphasis should be placed on whether the employee continues to perform services for the same affiliated group, or a successor group, which prior to the transaction was considered to be the “employer” for pension purposes. Similarly, the focus should be not on how a transaction is structured, but on whether the purchaser has assumed, or the seller has retained, the responsibility for the pension promise; i.e., whether the plan (or plan assets and liabilities) is retained by the seller or transferred to the purchaser.

Another goal is simplicity, by which we mean ease of interpretation and administration so as to minimize, to the extent possible, unnecessary administrative costs.

Finally, the same desk rule should be interpreted and applied in a way which is fair to both the employee and the employer.

Background and Current Precedents

The basic description of, and requirements relating to, qualified pension plans are contained in Treasury Regulation § 1.401-l(b)(1)(i). Among other requirements, the regulation provides:

> "A pension plan within the meaning of section 401(a) is a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement."

Accordingly, until a "retirement" has occurred no benefits, other than incidental benefits, may be distributed from a qualified pension plan.

This pension plan qualification requirement affects both defined contribution pension ("money purchase") plans and defined benefit pension plans although, as will be discussed further, the issues pertaining to defined benefit plans are more difficult to resolve because of their cost implications. The same desk rule represents the application of this requirement in the context of a disposition of all or part of a business conducted by a controlled group of entities.

There is remarkably little authority addressing the same desk rule in the context of Treasury Regulation § 1.401-1(b)(1)(i). Rev. Rul. 56-693, 1956-2, C.B. 282 appears to be the earliest ruling to address the issue of when a qualified pension plan may provide benefits prior to normal retirement. The ruling expressly holds that a pension plan that permits participants to withdraw the funds accumulated on their behalf prior to either the termination of the plan or a severance of employment on account of retirement, disability or death would fail to qualify under Code Section 401(a). Payout upon death and disability are permissible as benefits incidental to the main purpose of the plan. Payout upon retirement is, of course, permissible as well.

It should be noted that the ruling does not attempt to define "severance of employment" for purposes of the applicable regulation, nor does the ruling explain how the term "retirement" in Treasury Regulation § 1.401- 1(b)(1)(i) came to be interpreted as including any severance of employment.

This early revenue ruling was subsequently amplified in Rev. Rul. 74-254, 1974-1, C.B. 91. This later ruling concerns a money purchase pension plan that permitted in-service distributions to employees who were transferred to job locations that were not covered by the plan. With regard to in-service distributions made by the plan to employees transferred to new locations, the ruling holds that because the payments were not made on account of a termination of employment, the distributions were analogous to payments of layoff and sickness benefits, which may not be provided by a qualified pension plan. The ruling goes on to state that ". . . a pension plan does not qualify if it permits distributions prior to normal retirement and prior to termination of employment or termination of the plan . . ."

Implicit in the reasoning of the ruling is that permissible distributions are not limited to termination of employment on account of death, disability or retirement, but are permissible upon any termination of employment. The expansion of the term "retirement" to include any termination of employment appears to have taken place without any discussion or analysis in the revenue rulings.

In subsequent rulings, it is taken as a given that termination of employment constitutes a "retirement" permitting the commencement of a benefit under Treasury Regulation § 1.401-1(b)(1)(i). There is little if any discussion in these rulings of what constitutes a termination of employment. Moreover, the analysis of what constitutes a termination of employment appears to take place almost entirely in the context of Code Section 402(e)(4)(A), which permits plan participants to receive tax favored treatment with respect to lump sum distributions received upon a severance of employment (and in certain other instances as well).

The issue as to what constitutes a termination of employment for purposes of Treasury Regulation § 1.401-1(b)(1)(i) first arises in Private Letter Ruling 8614060. This ruling holds that in a situation where the transferred employees will be employed by the purchaser and will perform the same or substantially the same duties there is no termination of employment within the meaning of Treasury Regulation § 1.401-l(b)(1)(i). The holding, however, is based entirely on two earlier revenue rulings[3] both of which address the issue whether a sale, or other transaction, causes a “separation from service” within the meaning of Code Section 402(e)(4)(A), but not the issue whether such a sale, or other transaction, causes a termination of employment within the meaning of Treasury Regulation § 1.401-l(b)(1)(i). The ruling does not contain any discussion independent of Code Section 402 regarding whether a sale, or other transaction, may give rise to a termination of employment within the meaning of Code Section 401. Though Private Letter Ruling 8614060 does not explicitly hold that a separation from service under Code Section 402(e)(4)(A) constitutes a termination of employment under Code Section 401, the ruling does at least imply that the analysis under both provisions flows together.[4]

We believe, however, that the policy reasons underlying the two provisions are substantially different, and that this difference justifies a differing interpretation of the two provisions. Treasury Regulation § 1.401-l(b)(1)(i) sets forth the purpose for which pension plans are established. Pension plans are established for the purpose of providing benefits upon retirement, which has been interpreted to include any termination of employment. Any other purpose satisfied by a pension plan must be incidental to this purpose of providing retirement benefits.

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[3] The two Revenue Rulings are Rev. Rul. 79-336, 1979-2 C.B. 187 and Rev. Rul. 80-129, 1980-1 C.B. 86.

[4] Certainly many practitioners have assumed this to be the case, although our impression is that there is a legitimate variance of views among practitioners concerning the effect of a sale on the pension entitlement of an employee of the seller who thereafter becomes employed by the purchaser. In fact, the confusion concerning the current state of the law has led us to suggest, as we do at the end of this Report, that any definitive interpretation of the same desk rule be of prospective effect only.

In contrast, Code Section 402(e)(4)(A) permits plan participants to receive tax favored treatment on certain lump sum distributions made from a plan. The tax favored treatment is not contingent on a participant "retiring" under the plan. Rather, once a participant reaches age 59 1/2, such participant is eligible for favorable tax treatment, even if a separation from service has not taken place. Not only does this special rule not focus on retirement, but in some ways the special treatment afforded by Code Section 402(e)(4)(A) to lump sum distributions directly undercuts one stated purpose of pension plans, which is to provide retirement income on a yearly basis for the participant's lifetime.[5]/

As additional evidence of the different intent of these provisions, we note that a plan under which only lump sum distributions are available could never qualify as a pension plan. See Rev. Rul. 62-195, 1962-2, C.B. 125. Accordingly, there are obviously differing, and perhaps conflicting, policy objectives between Treasury Regulation § 1.401-1(b)(1)(i) -- which requires pension plans to provide retirement income over a period of years -- and Code Section 402(e)(4)(A) -- which encourages lump sum distributions and which is not premised upon retirement. Given the different policy reasons underlying the two Code provisions discussed above, we believe that the rules pertaining to Code Section 402 should not govern the interpretation of Treasury Regulation § 1.401-1(b)(1)(i).

[5]/ See, for example Code Section 401(a)(11), which requires that an annuity be the normal form of benefit from a pension plan.

Also relevant in this area is the emerging treatment in transactions of plans intended to qualify under Code Section 401(k) ("401(k) plans").[6]/ 401(k) plans are under a general statutory mandate not to make distributions prior to separation from service, attainment of age 59 1/2[7]/ or certain hardships. The Tax Reform Act of 1986, as amended by the Technical and Miscellaneous Revenue Act of 1988, added Code Section 401(k)(10), which expanded the permissible distribution events. This new provision was added in response to the practical problems that arise in transactions in which the seller maintains a 401(k) plan.

Code Section 401(k)(10) permits distributions from a 401(k) plan to commence if the seller sells, in either a stock or asset sale, substantially all of the assets of a business and continues to maintain the plan covering the transferred employees who now work for the purchaser. Payout is permissible because even though the transferred employees are employed by the purchaser (and thus it may be argued that a same desk rule type analysis should apply), the purchaser has not assumed the plan.

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[6]/ In this connection, we note that profit-sharing plans are not technically subject to the same desk rule. They are governed by Treasury Regulation § 1.401- 1(b)(1)(H), which limits permissible distributions from profit-sharing plans to the occurrence of "a fixed number of years, the attainment of a stated age or upon the prior occurrence of some event such as layoff, illness, disability, retirement, death, or severance of employment." Presumably, an "event" permitting distribution has occurred with respect to an employee who is affected by the sale of stock or assets, so that a distribution under such circumstances is permissible. However, because there is little guidance in this area, and to prevent confusion, the Service may wish to clarify this point in any guidance it issues in the same desk area.

[7]/ Significantly, the ability to commence distributions at age 59 1/2 is limited to profit sharing and stock bonus 401(k) plans. See Code Section 401(k)(2)(B)(i)(III). Pre-ERISA money purchase plans, which may also qualify as 401(k) plans, may not commence distributions at age 59 1/2.

The statute requires the original controlled group to continue to maintain the plan after the transaction. The justification for permitting distributions is that the entity employing the transferred employees is not part of the controlled group that maintains the plan providing the benefits to the transferred employees.

The existence of Code Section 401(k)(10) supports the conclusion that no termination of employment occurs where the transferred employee continues to work in the same job for the purchaser.[8]/ Code Section 401(k)(10) permits plan sponsors to make distributions even though no termination of employment has taken place. If a transferred employee who continued to work for the purchaser were deemed to have terminated employment, distributions from a 401(k) plan would be

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[8]/ Code Section 401(k)(2)(B)(i)(I) permits distributions of amounts deferred under Code Section 401(k) in the event of a participant's separation from service. The Service takes the position that the term "separation from service" has the same meaning for both Code Sections 401(k) and 402(e)(4)(A). Since the sale of a company division (or subsidiary) to a third party generally does not give rise to a separation of service within the meaning of Code Section 402(e)(4)(A), such a sale also does not give rise to a separation from service under Code Section 401(k)(2)(B)(i)(I). See PLR 8637099 ("an employee . . . [will not be considered separated from service within the meaning of Code Section 402(e)(4)(A)] when the employee continues on the same job for a different employer as a result of the liquidation, merger or consolidation, etc., of the former employer. This same rationale will apply to separation from service under section 401(k)(2)(B).") See also PLR 8631103 (same). But see PLR 8716057 (holding that sale of a subsidiary gives rise to a separation from service under Code Sections 401(k)(2)(B) and 402(e)(4)(A)). One company apparently attempted to circumvent the restrictions imposed by the Service's definition of separation from service by providing that the 401(k) plan would be terminated upon the sale of the company's division to a third party. However, because a plan termination was not a permissible distribution event under Code Section 401(k)(2)(B), distributions from the plan still were not permitted. See PLR 8536042. See also PLR 8546093 and PLR 8441071 (holding that distributions upon termination of profit-sharing 401(k) plans could not be rolled over because entire balance in the 401(k) plans could not be distributed (only non-401(k) amounts could be distributed)).

allowable as being on account of termination (separation from service) and there would be no need for the statutory exception created by Code Section 401(k)(10). We think that Code Section 401(k)(10) is also significant because it represents a statutory response to the problem of how to deal with 401(k) plans in transactions -- much as the same desk rule is a response to the problem of how to deal with pension plans in transactions.

Questions Raised by Transactions

Before discussing the applications of the same desk rule in detail, it is helpful to put the rule in the context of other questions which arise in a transaction. Nearly every transaction that affects employees raises several questions regarding the appropriate treatment of transferred employees:

1. If a transferred employee is otherwise eligible for retirement, can he or she begin to draw a benefit while continuing to work for the purchaser? If not, when may the pension commence?

2. If a transferred employee has not yet attained eligibility for retirement from the seller's plan can he or she become eligible due to additional periods of service with the purchaser?

3. If a transferred employee is not yet vested under the seller's plan, will vesting credit continue on account of continued service with the purchaser?

4. Is a transferred employee entitled to severance pay, post-retirement medical or life insurance benefits from the seller?

The “same desk” rule in theory only affects the first question, i.e., the date upon which the payment of benefits may commence. But it may affect, and of equal importance, should not produce results inconsistent with, the responses to the remaining questions.

Application of Principles to Transactions

There are several alternative ways to structure a transaction and treat the pension plan covering the transferred employees that can affect the application and legal analysis of the same desk rule. In determining a pension plan participant's right to “retire” and the ability of the employer to commence payment of benefits, we believe that the critical question is what happens to pension assets and liabilities and not whether a transaction is structured as a sale of stock or assets.

Since the inception of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), the focus has been on the controlled group for which the employee was performing services, rather than the common law employer of the employee. While in a stock sale the common law employer of the transferred employee remains the same, and in an asset sale the common law employer changes, the identity of the common law employer is not particularly meaningful under ERISA. Among other things, the controlled group concept, articulated in Code Section 414(b),(c),(m) and (o) controls:

a. Coverage and discrimination testing which is performed on a group-wide basis. Code Sections 401(a)(4), 410 and 411;

b. Liability for the pension promise. Under the amendments to the Code enacted by The Omnibus Budget Reconciliation Act of 1987, all members of the controlled group are liable for failure to meet the minimum funding standard requirements. Code Sections 412 and 4971.

c. Maximum benefits permitted by the Code. code Section 415.

d. Whether a plan is "top heavy." Code Section 416.

e. Liability to the Pension Benefit Guaranty Corporation ("PBGC") in the event of termination of an underfunded plan. ERISA Sections 4062 and 4001(b).

f. Multiemployer withdrawal liability. ERISA Sections 4201 and 4001(b)[9]/

It is evident that for many purposes the most critical aspect of a transaction from a pension perspective is whether the employee becomes part of a different controlled group rather than whether the transaction was structured as a sale of assets or a sale of stock. (Of course, the sale of stock of a parent corporation either does not affect the composition of the controlled group or creates a new surviving controlled group that consists of both prior controlled groups. In neither instance should any concern regarding the application of the same desk rule arise. There is simply no justification for payment of pension benefits to commence while the employee remains employed by the surviving controlled group.)[10]/

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[9]/ The multiemployer withdrawal liability provisions do differentiate between a sale of assets and a sale of stock. See ERISA Section 4204. However, this disparate treatment arises from the fact that the critical event in determining liability in such instances is a cessation or significant decrease in contributions to a plan, rather than a plan termination or a termination of employment.

[10]/ Code Sections 401(k)(10) and 409(d) lend support to this conclusion that the payment of benefits should not commence so long as the employee either remains employed by the surviving controlled group or the employing entity is a part of the same controlled group that maintains the plan covering the employee.

Further, a transaction that would have been structured as a sale of assets can often be restructured as a stock transaction merely by dropping the assets to be disposed of (and related employees) into a newly formed subsidiary and then selling the stock of the subsidiary. This change in the structure of the transaction should not logically affect whether the seller is able to pay out the pension benefits of its employees. For pension purposes this is an artificial distinction and is not as important, in our view, as whether the seller retains or the buyer assumes the pension promise as a result of the transaction. Accordingly, treatment of stock and asset transactions should be the same. This rule should apply even if the transaction is structured as a spinoff or other tax-free transaction, as opposed to a taxable sale of stock. The focus instead should be on what happens to pension plan assets and liabilities.

Situations Where Plan Assets and Liabilities are Transferred

1. “Stand-Alone” Plans.

The pension plan covering the transferred employee can be a “stand-alone” plan; i.e., a plan covering only transferred employees (and retirees), which is assumed by the purchaser. If the “stand-alone” plan is to continue after the transaction it will be assumed by the purchaser and either maintained separately or merged into another plan of the purchaser.

In either event there would seem to be no basis for permitting participants to retire and benefits to commence since the employing entity continues to be a part of the controlled group that maintains the plan. This position is consistent not only with Code Section 401(k)(10), discussed above, but also with Code Section 414(a)(1), which provides that “in any case in which the employer maintains a plan of a predecessor employer, service for such predecessor shall be treated as service for the employer.” Given such statutorily mandated treatment with regard to service performed for the seller, it would be patently wrong to treat the employee as having “retired” or otherwise separated from service of the employer as a result of the transaction.

2. Transfers of Assets and Liabilities.

The pension plan may cover a larger group of active employees of the seller than the transferred employees, in which case the plan may be split, and appropriate assets and liabilities transferred to, a successor plan of the purchaser.

Where a pension plan is split, to the extent that assets and liabilities are transferred to a plan of the purchaser, the analysis should be the same as in the case of a stand-alone plan. The regulations under Code Section 414(1) require that the purchaser's plan receive an appropriate amount of assets with respect to the transferred employees. In addition, because Treasury Regulation § 1.414(1)-1(n) requires that in spinoffs involving defined benefit plans,[11] all assets and liabilities with respect to a particular participant be wholly allocated to one of the plans resulting from the transfer of assets and liabilities, it will be clear after the transaction whether the seller has retained or the purchaser has assumed the pension promise. Code Section 414(a)(1), discussed above, applies equally to the spinoff plan, in the hands of the purchaser, as it does to the “stand-alone” plan situation. Accordingly, there is no reason to permit the commencement of pension benefits where assets and liabilities are transferred from a pension plan of the seller to a pension plan of the purchaser.[12]

Situations Where Plan Assets and Liabilities are Not Transferred.

Where the seller retains the pension plan covering the transferred employees and does not transfer assets and liabilities to a pension plan maintained by the purchaser, the transferred employee has clearly become separated from

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[11] While the rules relating to spinoffs of assets and liabilities from money purchase plans are not as explicit, we are not aware of any instance where assets and liabilities in a money purchase plan relating to a particular participant have been split between the transferor and transferee plan.

[12] We believe that the above results should pertain regardless of whether the purchaser's plan provides benefits which are comparable to the seller's plan. In either the "stand-alone" or "spinoff" structure, future accruals could be reduced at any time by the purchaser, provided the purchaser supplied the requisite 15 day notice of reduction in benefit accrual required by ERISA Section 204(h), so that continuance of a plan by the purchaser is no guarantee of continued accruals at the same rate, just as continuation of accruals by the seller at prior levels was not guaranteed.

the entity that is responsible for the pension promise. The seller's plan which covered the transferred employee will either continue as an ongoing plan for the seller's remaining employees or it will be frozen or terminated.

The purchaser may provide a pension plan which affords transferred employees full past service credit,[13] limited past service credit (e.g., eligibility and vesting only) or no past service credit. The purchaser may also decide not to maintain any pension plan for the transferred employees. The seller often, but not uniformly, provides additional vesting credit under the seller's plan for service with the purchaser, or may fully vest the transferred employees. Any of several variations may occur in the same transaction among various groups of transferred employees.

13/ The analysis becomes more complex where the purchaser does not assume the plan (or that part of it attributable to the transferred employees) but maintains a pension plan of its own for transferred employees and grants full past service credit under that plan to transferred employees for benefit accrual purposes for service with the seller, with an offset for the benefit provided by the seller's plan.

This structure could potentially be viewed from a legal perspective in the same way as the "stand-alone" or "spinoff" structures discussed above, because the purchaser has placed the transferred employee in essentially the same position as if the plan had been assumed, even though the pension assets attributable to the transferred employees' prior pension accruals remain with the plan of the seller. We are persuaded, however, that because the assets and liabilities attributable to the past services of the transferred employees remain with the seller, this structure should be treated no differently than the situation in which the purchaser does not maintain any plan for the transferred employees. This view is consistent with the PBGC's view of this type of transaction. See PBGC Adv. OP. 86-9.

We believe that developing complex rules which attempt to consider separately any transaction, based on each of the foregoing variables, will create a difficult, if not unworkable, situation for companies involved in such transactions. Rather, we propose broad general rules which: (i) have application regardless of the structure of the transaction, and (ii) attempt to treat similar pension plan structures in the same way.

In making our proposal, we are also cognizant that the financial impact of this question on the employer can be significant.[14]/ Many defined benefit pension plans contain provisions which entitle a participant who takes early retirement to a subsidized early retirement benefit. The rationale for such benefit is to encourage employees to consider early retirement. Actuaries assume, for purposes of plan funding, that a certain number of employees who reach early retirement age will choose early retirement and provide for funding of plans accordingly. If 100% of the transferred employees of early retirement age may draw down early retirement benefits without actually leaving their jobs because they have "retired" upon transfer to the purchaser, the cost to the seller to fund these unanticipated benefit subsidies can be substantial. Moreover, the original purpose of the early retirement subsidy -- to encourage early retirement -- would be subverted.

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[14]/ The discussion of cost which follows applies to defined benefit pension plans. Money purchase plans do not raise similar cost issues because the liability under the plan is limited to the participant's account balance.

Same Desk Rule in Principle

The tension in applying the same desk rule in these situations arises from conflicting analyses suggested by the fact that the employee is no longer employed by the same “employer” for pension purposes and the fact that the transferred employee is continuing to work for the purchaser and has not “retired” or terminated employment within the normally understood meaning of that word. As a policy matter, the question is whether the fact that the “employer” for whom the transferred employee works is no longer the “employer” that is providing the pension promise should be deemed to effect a “retirement”, so as to permit the seller's plan to pay out a benefit, or whether such a payment would be inconsistent with the intent of Treasury Regulation § 1.401- l(b) (l)(i).

We believe that even though transferred employees have clearly ceased to be employed by the “employer” providing their pension benefits, if the seller continues to maintain the pension plan covering the transferred employees, there is no compelling policy reason, and no particular justification, based on existing authority, to permit such transferred employees to begin receiving retirement benefits, even if they are then eligible for retirement based on applicable age and service requirements prescribed by the seller's plan. If, of course, an employee who was already eligible for retirement under the seller's plan subsequently terminates employment with purchaser, the appropriate retirement benefit would be payable from the seller's plan.

We believe that the developments in the area of Code Section 401(k) support the position that, absent a compelling policy reason and explicit authority, the fact that the “employer” sponsoring the plan is no longer the same as the “employer” for whom the transferred employee works should not by itself justify the payment of a benefit which, under applicable qualification rules, is to be postponed until retirement or other termination of employment. In fact, the case for the same desk rule is more compelling in the pension plan area than in the 401(k) area. Many, though certainly not all, 401(k) plans merely supplement the main pension promise of the employer, which is often provided through a defined benefit plan. Therefore, the policy reasons to defer the receipt of a benefit from a 401(k) plan until “retirement” are not as strong. Secondly, unlike a periodic pension payment, a 401(k) benefit, which is usually paid in a lump sum, can be rolled over and preserved for future use after the transferred employee's actual retirement. See Code Section 402(a)(6)(B).

Accordingly, we are not fundamentally opposed to the Service's conclusion in PLR 8614060. We do, however, utilize a different analysis to reach that result. We further believe that the Service has the authority to interpret existing law so as to permit exceptions to the same desk rule. Unlike the 401(k) area, where a statutory amendment was needed as an explicit exception to the statutory limits on benefit payments under a 401(k) plan, there is no statutory articulation of the circumstances under which a pension benefit may be paid out.

Proposed Exceptions to the Same Desk Rule

Moreover, although we agree with the same desk rule in principle, we nevertheless also believe that exceptions to the rule should be made in those circumstances where payouts of pension benefits to transferred employees from the seller's plan may be justified.

1. De Minimis Benefits. Consideration should be given to the negative effects on the seller of having to hold in its plan benefits for transferred employees whose benefits are minimal. In such case, the aggregate expense of maintaining the assets (including, in the case of a defined benefit plan, the ongoing payment of PBGC premiums) and otherwise administering the pension plan with respect to such minimal benefits may exceed the benefit itself. Accordingly, we would propose that a seller be permitted to make lump sum distributions from its plan of benefits, the present value of which does not exceed $3500, to transferred employees. This would obviate the legitimate concern expressed by employers with respect to the burdens of retaining such assets.

2. Elective Distributions from Seller's Plan. We also believe that it is appropriate under certain circumstances to permit the seller to distribute amounts from its pension plan on an elective basis to the extent permitted by the plan document. In short, there is no reason, where the seller has retained the plan, to deny the seller's plan the ability to commence payouts of pension benefits immediately (in the case of a lump sum

distribution) or upon attainment of retirement age (in the case of an annuity payout) if adequate protections have been afforded to the transferred employees. One underlying reason for this proposal is that in all of the circumstances in which the seller retains the pension plan relating to transferred employees the seller has the option available to it, so long as the pension plan is fully funded, to terminate the plan and distribute appropriate benefits to the transferred employees. In the case of a stand-alone plan this could be accomplished by merely terminating the plan. In the case of a plan covering a broader group of employees this would have to be accomplished by means of a “spinoff/termination”, which would have additional consequences to the ongoing plans of the seller.[15]/

We believe that in the divestiture situation it is appropriate to permit the employer to pay out currently the benefits (either in a lump sum or an annuity payable upon retirement) to the transferred employees so long as (i) the seller's plan is fully funded (on a termination basis) on the closing date of the applicable transaction and (ii) all transferred employees are fully vested as of such date.

This provision in effect permits employers to treat dispositions involving transferred employees as partial terminations of their existing plans. While all of

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[15]/ For example, full vesting and annuitization or lump sum payments of all plan benefits might be required. See PBGC News Release No. 84-23, also known as the "Implementation Guidelines."

the protections of a full termination (e.g., the protections of annuities) are not afforded to the transferred employees, the major substantive protection of termination; i.e., full vesting, is afforded to those employees. In effect, this is the toll charge to the employer for the privilege of paying out benefits to affected employees and relieving itself of substantial ongoing administrative burdens.[16]/

Effective Date of New Rules

It is important to make the foregoing rules (and clarifications of existing rules) prospective only. This has not been an area which has been the subject of clear Congressional or regulatory guidance. Accordingly, employers have in the past legitimately adopted differing approaches to the treatment of pension plans in transactions in the absence of such guidance. These approaches should be grandfathered and there should be a transition period of, for example, one year after publication of the Service's rules in this area, during which pension plans may be amended to reflect compliance with the new rules. In addition it would be appropriate to give relief where such amendments would be prohibited by Code Section 411(d)(6).

Another reason for the importance of the delay in application of any published rules is that other benefits, such as post-retirement medical and life insurance benefits

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[16]/ It may be argued that the toll charge to the employer should include the requirement that transferred employees be permitted to "grow-in" to early retirement. See Rev. Rul. 86-48, 1986-1 C.B. 216. However, the Committee has not yet developed a consensus view regarding this issue.

are often premised upon “retirement” within the meaning of the applicable pension plan, and a substantive change in those events which constitute or give rise to a “retirement” could result in very substantial unanticipated costs to employers.