L-99-20
December 6, 1999

TO: Ron Russo
Acting Director of Policy and Systems

FROM: Steven A. Bartholow
General Counsel

SUBJECT: IRS supplemental Pension Plan Regulations

This is in response to your memorandum of October 8, 1999, concerning new regulations dealing with the definition of a supplemental pension plan under section 3221(d) of the Internal Revenue Code (IRC).

On August 6, 1999, the Internal Revenue Service (IRS) published a final regulation defining the term "supplemental pension plan" for purposes of section 3221(d) of the Internal Revenue Code (IRC). Under that section an employer who enters into a negotiated supplemental pension plan is exempted from the work-hour tax under section 3221(c) with respect to the employees covered under the plan. Instead, the employer pays a tax equal to the supplemental annuities payable under the Railroad Retirement Act (RRA) to employees covered under the plan. Payments from the plan, however, reduce the amount of supplemental annuity payable as provided for in section 2(h)(2) of the RRA. An employer who maintains a non-negotiated supplemental pension plan pays the work-hour tax but receives tax credits to the extent supplemental annuities are reduced by payments from that plan. Specifically, a new section 31.3221-4(b)(2) of 26 CFR provides in part:

> (2) Pension benefit requirement. A plan is a supplemental pension within the meaning of this section only if the plan is a pension plan within the meaning of 1.401-1(b)(1)(i) of this chapter. Thus, a plan is a supplemental pension plan only if the plan provides for the payment of definitely determinable benefits to employees over a period of years, usually for life, after retirement * * * .

64 Fed. Reg. 42833 (1999).

Under the new IRS rule, the definition of supplemental pension plan for purposes of section 3221(d) covers what are commonly known as defined benefit plans, and money purchase plans. Defined contributions plans, including section 401(k) plans, would not meet the definition.

Your first question deals with lump-sum payments from money purchase plans. A money purchase plan is a defined contribution plan where the employer's contributions are fixed and not dependent upon profits. A money purchase plan meets the definition of "pension plan" under section 1.401-1(b)(1)(i) of the regulations under the IRC and would, therefore, be a supplemental pension plan for purposes of section 3221(d). If a money purchase plan results from collective bargaining, an employer would be relieved from the hour tax under section 3221(c) with respect to employees covered under the plan. Payments from a money purchase plan reduce the supplemental annuity pursuant to section 2(h)(2) of the RRA. If payments are made in a lump sum, then the reduction should be computed in accordance with the advice in Legal Opinion 89-112.

Your next set of questions deals with plans which the Board has approved as supplemental plans, but which would not meet the definition of pension plans for purposes of section 3221(d). Specifically, the agency has approved a number of section 401(k) plans, which require employer matching contributions, and a number of retirement plans which provide only for lump-sum payment.

The agency has not changed its definition of supplemental pension plan under section 2(h)(2) and consequently benefits paid from the plans you reference should continue to reduce the supplemental annuity. Section 3221(c) (second paragraph) of the IRC provides that any employer whose employees' supplemental annuities are reduced pursuant to section 2(h)(2) of the RRA shall be allowed a credit against the hour tax imposed by that section in the amount of the aggregate amount of reductions in the supplemental annuities. The employers who maintain the plans in question may no longer escape the hour tax by virtue of section 3221(d), because such plans no longer qualify as pension plans for purposes of that section. However, as long as the Board continues to reduce the supplemental annuities of the employees of these employers as the result of payments from these plans, it would appear that section 3221(c) would provide that they receive matching tax credits.

Your next set of questions deals with the situation where an employee attains retirement age under a plan but receives a lump-sum benefit instead of a monthly annuity. In some cases the employee's potential benefit is so small it

is not feasible to pay him an annuity and therefore the plan calls for a lump-sum payment. This situation was addressed in Legal Opinion 89-112. In that opinion we advised that in such a circumstance, the employer could provide a theoretical annuity for purposes of the supplemental annuity reduction or, absent such information, the Board could simply divide the lump sum by the amount of the employee's supplemental annuity and determine the number of months the supplemental annuity is not payable. Some plans may provide a lump-sum benefit upon the employee's termination of employment prior to attaining employment age under the plan. Such a cash payment is not made on account of retirement and would have no effect on any supplemental annuity which may ultimately become payable.

Your next set of questions deals with what employees are covered under negotiated pension plans for purposes of section 3221(d). Section 31.3221-4(c) of the new regulations referenced above provides:

> (c) Collective bargaining agreement. A plan is established pursuant to a collective bargaining agreement with respect to an employee only if, in accordance with the rules of 1.410(b)-6(d)(2) of this chapter, the employee is included in a unit of employees covered by an agreement that the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and one or more employers, provided that there is evidence that retirement benefits were the subject of good faith bargaining between employee representatives and the employee or employers.

Section 31.3221-4(e)(2) provides that this section is effective on January 1, 2000.

In the past employers have extended collectively bargained plans to their non-bargaining unit employees. As result of the above-regulation, effective January 1, 2000, an employer will not be relieved of the hour tax with respect to these non-bargaining unit employees even though they may continue to be covered by the plan. However, since these individuals remain covered by a supplemental pension, any supplemental annuities payable to these employees should be reduced by benefits payable from these plans and the employers should receive a matching tax credit for these reductions.

Your final question concerns the finality of IRS Form CT-1, Employer's Annual Railroad Retirement Tax Return. Section 6501 of the IRC generally provides that a tax may not be assessed for a tax year more than 3 years after the return for the year was filed. The regulation in question was effective October 1, 1998. Employers who should have paid the hour tax with respect to

employees who were incorrectly treated as covered under section 3221(d) may be subject to additional taxes for 1998. Of course, this is an issue under the jurisdiction of the Internal Revenue Service, not the RRB.

Ron Russo

Based on existing precedent, we continue to consider defined contribution plans to be supplemental pension plans under section 2(h)(2) of the RRA, but we do not consider negotiated defined contribution plans to meet the definition of supplemental pension plans for purposes of section 3221(d). In view of the potential tax questions to arise concerning section 2(h)(2), we believe it would be advisable for the Board to provide guidance.