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IN PRAISE OF PENSION REFORM

BY RONALD I. KIRSCHBAUM*

Many in the practicing Bar seemed to go into a state of shock when the magnitude of the Employee Retirement Income Security Act of 1974 (ERISA) became apparent. Noteworthy authors speculated on the possibilities of survival of the small plan.1 The number of plan terminations quickly rose until they nearly equalled the number of plan qualifications.2

This hue and cry has not abated significantly, and journal articles continue to bemoan the horrendous complexities of the new law.3 The general practitioner attempting to advise small-business clients must confront a myriad of new concepts, such as fiduciary standards, the Pension Benefit Guaranty Corporation and anti-backloading actuarial concepts. In addition, when the practitioner turns to experts in the field, he finds them saying how nearly impossible modern retirement planning is. Small wonder then that such practitioners run for cover. However, a non-emotional analytical view of the past five years will reveal a different picture. Instead of the hydra-like monster ERISA has been painted to be, it represents a system of law that is considerably more certain and easier to apply than that at anytime in the recent past. Practitioners who do not recognize this and who continue to refrain from using retirement plans in corporate planning are denying their clients the most effective and one of the last available tax shelters.

This article will examine the current state of the law as compared to the situation that existed prior to the passage of ERISA. An exhaustive analysis of the intricate details of ERISA is not intended. Nevertheless, a comparison of some of the most salient provisions of pre-ERISA and post-ERISA law will reveal that things were not all that good before September 2, 1974, and they are not all that bad now.

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2. During the calendar year 1976, the IRS processed a total of 21,486 initial qualifications and 15,859 terminations. COMPLIANCE GUIDE FOR PLAN ADMINISTRATORS (C.C.H.) No. 35 (July 22, 1977).

The analysis will be confined largely to defined contribution plans. Even before ERISA, the uncertainty of actuarial funding and the complexities of defined benefit plans made the defined contribution plan much more attractive for the small business. ERISA simply has accentuated this difference. The advent of the Pension Benefit Guaranty Corporation and the potential of substantial employer liabilities, together with increased complexity and operational costs, have made defined benefit plans too expensive for many small businesses. Attorneys should not exclude such plans automatically since in some situations they will prove ideal.

LEGISLATIVE BACKGROUND

A comparison of the old and new laws must take into account the historical background of legislation in this area. Congress began its policy of substantial tax preferences for privately funded and maintained retirement programs with the Revenue Act of 1921. This initial legislation, together with subsequent codifications, remained essentially skeletal. The Internal Revenue Code of 1954 merely contained provisions governing deductibility of contributions, basic rules of nondiscrimination and a vague list of prohibited transactions.

Perhaps this basic outline type of legislation sufficed in a simpler time. By 1974, however, the private pension system was an industry estimated to have assets in excess of 150 billion dollars and to have millions of participants. The nuances and complexities of the system had long surpassed the explicit or implicit language of the statute. There quite naturally developed, therefore, a large body of administrative regulations and rulings designed to give guidance where the statute failed to speak.

4. There has been a marked increase in the popularity of defined contribution plans. In 1975, 15,319 pension and annuity plans were approved as against 14,720 stock bonus and profit-sharing plans. From January through September of 1976, 12,940 letters were issued for defined contribution plans with only 1,330 letters for defined benefit plans. I.R. 1557 (Feb. 10, 1976), and I.R. 1968 (Nov. 19, 1976).

5. Overenthusiastic estimates of of ERISA-related costs have served to increase apprehension. Articles in the Journal of Pension Planning and Compliance estimated cost of bringing plans into compliance at $6,000-10,000 and further administrative burdens at $500-1,000. See 4 J. Pension Plan. & Compliance, No. 4 (July, 1978). However, a Price Waterhouse study done for the Department of Labor revealed that the cost of bringing a plan into compliance averaged $700. Fees were $105 for 5500-C forms and $78 for summary annual reports. See Compliance Guide for Plan Administrators, (C.C.H.) No. 59, (June 23, 1978).

It may be observed that this is the proper relationship between a statute and administrative interpretations. Regulatory action, however, went far beyond interpretation. Concepts that were not even considered by the drafters of the statute were described in the regulations and were in common use. By way of example, the regulations required that all pension plans have actuarially determined benefits. No mention was made of the defined contribution pension plan. Nevertheless, the so-called "money purchase pension plan" was in everyday use. What amounted to virtual bureaucratic legislation went so far that speeches and letters of the Chief of the IRS Pension Trust Division were published by the private pension services and quickly became tantamount to law.

The Internal Revenue Service could coerce compliance with its administrative fiat through use of the favorable determination letter. Often the rules imposed went beyond published regulations and amounted to nothing more than the individual District Director's concept of equity and fair play. Substantial inconsistency resulted, and compliance in one district could result in an unfavorable or caveated determination letter in another.

The drafters of ERISA also recognized abuses in plan administration. Those responsible for administration of an industry recognized to be in the billions of dollars were largely unsupervised, and the prohibitions against self-dealing were sketchy at best.

Obviously, the time was ripe for substantive change in the legislation. This came on September 2, 1974, when President Ford signed into law the Employee Retirement Income Security Act of 1974. This legislation was the culmination of years of work and constituted virtually a total overhaul of the laws governing private retirement plans in this country.

By necessity, such far-reaching legislation is complex and difficult for the private retirement system to assimilate. However, the employer considering the adoption of a retirement program will find that he now has available a system of laws with relatively certain

7. Treas. Reg. § 1.401-1(b) (pre-ERISA).
8. The regulations allowed for use of the pension plan which provided for definite contributions. Such a plan promised no specific benefits to employees. The IRS determined that since the contributions were fixed, application of actuarial assumptions would produce a definitely determinable benefit. Even prior to ERISA, there has been permitted a combination of combined benefit and money purchase plans called the target benefit or assumed benefit plan. This allows computation of benefits on an actuarial basis, conversion of those benefits to annual contributions and the making of contributions on a money purchase basis.
requirements and flexible alternatives. Following is a step-by-step description of some of the improvements afforded by the new law which are available to the small business and its advisers.

**Definition of Employer**

An employer considering the adoption of a qualified retirement plan probably first will consider the legal requirements regarding employee coverage. The ultimate cost to the employer to a large degree will be a function of the number of required participants. The first consideration that must be given in determining the coverage requirements is the definition of the employer who is maintaining the plan.

Prior to the passage of ERISA, the separation of employers into two or more employing organizations, such as a corporation and a partnership, was often a planning tool used to exclude substantial numbers of participants. The law was extremely vague, and the only real attack the Internal Revenue Service could make was a broad-sided one based upon general principles of discrimination and equity. It was not unusual to see employees of an essentially unitary business divided into a partnership and a corporation with substantially different benefits provided for retirement. Judicial determinations have held this practice to be improper in some circumstances, but until 1974, the law remained unclear.\(^{10}\) In some cases, differential treatment was even mandated, as in the case of profit-sharing plans of affiliated corporations. The Internal Revenue Service ruled that a qualified plan could not allow forfeitures to be reallocated to employees of corporations in an affiliated group other than the corporation that made the contribution.\(^{11}\)

The passage of ERISA virtually has ended all speculation in this area. For purposes of coverage and benefits, the law now requires all commonly controlled organizations to be aggregated as if they were one. This includes corporations, sole proprietorships and partnerships. The Code contains percentage tests to be used in determining what organizations are under common control.\(^{12}\)

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10. Employee's partnership could not be attributed to corporation solely because no control existed within the meaning of section 707(b), section 179 and section 267(b) of the Code. Thomas Kiddie, M.D., Inc. v. Commissioner, 69 T.C. 1055 (1978); Packard v. Commissioner, 63 T.C. 621 (1975).


12. I.R.C. § 414(b)-414(c). Two corporations that have identity of ownership will be deemed one entity as will a corporation and a partnership that are controlled by the same individuals.
Once the relevant employer is defined, the prospective contributor to a qualified plan will want to ascertain who among the employee group is to be included in the plan. Basic principles in qualified plans of deferred compensation are designed to hold discrimination against rank and file employees to a minimum. Pre-ERISA law again resolved few uncertainties. The statute seemed to indicate that a waiting period of up to five years was permitted. The Internal Revenue Service disagreed and litigated several cases, alleging discrimination in practice. An example of this type of litigation is *Ets-Hokin & Galvan, Inc.* where the court held that a five-year waiting period was reasonable even though 90% of the otherwise eligible employees were not participating in the plan.

The permissibility of a minimum age requirement for eligibility was also uncertain. It was not unusual to find plans requiring five years of service and attainment of age 30 for eligibility. When these requirements were coupled with extended vesting schedules, such plans often benefited very few rank and file employees.

As in the case of the employer definition, ERISA made the law clearer and more certain in the area of eligibility requirements. The maximum age that now can be required for entrance into a plan is 25. An employer may require a waiting period for an employee otherwise qualified to enter the plan. However, this period may not exceed one year unless the plan provides for full and immediate vesting, in which case the waiting period may be up to three years. The statute further requires that an employee be admitted to the plan on a date no later than six months after completion of all eligibility requirements. An employer evaluating the prospects of establishing a plan therefore knows that each qualified employee must become a participant no later than six months after the employee achieves one year of service and attains the age of 25.

In defining eligibility, the law now uses the term “year of service,” new under ERISA. The law defines a year of service for eligibility as any twelve-calendar-month period during which the employee puts in 1,000 or more hours of work for the employer.

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definition replaces the old part-time/full-time dichotomy. Numerous relatively unique situations such as seasonal agricultural workers and maritime workers are addressed specifically by the statute and regulations. The broad cross section of employees, however, will come within the general 1,000-hour definition and administration should be relatively easy. Contrary to prior law, the definition does not relate to normal or customary employment, but rather to the actual hours of employment. Marginal situations, therefore, may require extensive record keeping.

Application of the year of service concept necessitates another definition. The Department of Labor regulations specifically define "hour," and the definition may be incorporated by reference into a plan document.

COLLECTIVE BARGAINING UNITS

Prior to the passage of ERISA, one aspect of coverage was becoming more troublesome in North Carolina each year. This problem was the question of what to do when a collective bargaining unit was part of the employee group. Pre-ERISA coverage requirements did not permit exclusion of union members specifically; therefore, the "safe harbor" percentage tests were often not applicable where a union was involved. If the union did not want to bargain for a plan substantially equivalent to that desired by the employer, the employer then had to decide whether to offer the plan as an incidental and additional benefit to the union contract or to run the risk of possible disqualification.

This dilemma has been resolved under the current law by excluding collective bargaining units from the definition of employees, if the subject of retirement planning was the topic of good faith bargaining. This does not mean that the contract must provide for a retirement plan. If the bargaining unit opted for increased current benefits over deferred benefits, retirement planning was nonetheless

22. 29 C.F.R. § 2530.200b-2(b) to -2(c) (1977).
24. Loper Sheet Metal, Inc., 53 T.C. 385 (1969). A profit-sharing plan was held to be discriminatory where it excluded union employees. The union had a plan, but contributions were only about 1/5 of those for salaried employees. Loevsky v. Commissioner, 471 F.2d 1178 (3d Cir. 1973). The fact that the employer could not control what the union was going to bargain for was not relevant for qualifications of the plan.
the subject of good faith bargaining.

Once the employer is defined and permissible exclusions are spelled out, the percentage coverage requirements and anti-discrimination rules remain essentially the same as prior to the passage of ERISA.

**Contributions**

The next topic a prospective contributor should consider is the establishment of parameters with regard to contributions. The law prior to ERISA left much to the imagination. The statutory definitions related to limitations on contributions while the minimum and maximum levels of benefits and concomitant contributions were established by administrative rule. In regard to defined benefit plans, the Service generally held that benefits in excess of 100% of compensation no longer fell within the realm of retirement planning. In the case of the undefined money purchase plan, however, similar limitations were difficult to come by. Using the guideline of the 100% of compensation benefit, a rule of thumb gradually evolved that money purchase plans which provided for contributions in excess of 25% of compensation would not be permitted, absent a showing of reasonableness in the anticipated benefits to be provided. Isidore Goodman, the former chief of the Pension Trust Division of the Internal Revenue Service, announced this rule in a speech which was published and quickly picked up by the District Directors’ Offices. Within a short time, this rule of thumb became de facto law and the District Directors went so far as to issue adverse determination letters where money purchase plans provided for contribution levels in excess of 25%.

After many years of use, the defined contribution pension plan now has made it to the pages of the Internal Revenue Code. Limitations are put on the amount that may be contributed under such a plan each year on behalf of each participant. To no one’s surprise, the limitation contained in section 415(c) of the Code is 25% of the participant’s annual compensation.

Prior to the passage of the Pension Reform Act, no statutory limitations existed on the dollar amount of contributions to a defined contribution plan. As previously indicated, percentage limitations applied, but the dollar amount of the contribution increased

26. I.R.C. § 404, amended by ERISA.
29. I.R.C. § 415(c).
without limitation as compensation to a participant increased. This is no longer the case, and contributions on behalf of a participant must not exceed the lesser of the 25% figure previously discussed or $25,000, adjusted by the Secretary for inflation post-ERISA.\textsuperscript{30} This dollar amount limitation, generally referred to as the “maximum annual addition,” must be provided for in the qualified plan. In no event may the administrators allocate to the account of any participant an amount in excess of the maximum annual addition.\textsuperscript{31} The Code defines the annual addition to a participant’s account as being the sum of the employer contributions, forfeitures allocated to the participant’s account\textsuperscript{32} and the lesser of the amount of the employee’s contributions in excess of 6% of his compensation or one-half of all employee contributions.

These calculations should be scrutinized closely since an error can be costly. One common mistake is to confuse the limitations on voluntary contributions by participants under ERISA with the maximum annual addition computations. As a general rule, an employee participant may contribute up to 10% of the aggregate amount of all his compensation for all years in which he has been a participant in the plan.\textsuperscript{33} This is true even if voluntary contributions are lumped into one plan year. In making these contributions, only 6% of the current year’s compensation can be contributed on a voluntary basis without being included in that year’s maximum annual addition. Therefore, a large and perfectly permissible voluntary contribution can have the effect of substantially reducing the employer’s allowable addition to the account and causing a reallocation of employer contributions to other participants’ accounts.

Another factor that enters into the computation of the maximum annual addition is the period of time during which the limitation is calculated. The regulations provide for the determination of a “limitation year” by the employer. If the employer fails to determine a limitation year, the year automatically will be the calendar year.\textsuperscript{34} Assuming a fiscal year plan and employer, failure to determine a plan limitation year may have the effect of bunching contributions into one year and causing excess additions to a participant’s account which must be reallocated.

Section 415 also places limitations on the amount of benefits that can be paid from a defined benefit plan. While the subject of

\begin{enumerate}
\item Id.
\item Id.
\item I.R.C. § 415(c)(2).
\item Rev. Rul. 75-481, 1975-2 C.B. 188.
\end{enumerate}
defined benefit plans is beyond the scope of this article, it is necessary to consider the limitation on benefits. The Code provides for aggregate limits where more than one plan is in existence, and additional contributions to a defined benefit plan may have the effect of limiting contributions allowed to a defined contribution plan.

If there are multiple defined contribution plans, the limitation is simply the 25% or $25,000 figure discussed previously. Contributions for all plans are aggregated in determining a participant’s standing under these limitations. The difficulty arises, however, when one must combine benefits under a defined benefit plan and contributions under a defined contribution plan. Obviously, a simple addition of benefits and contributions is not appropriate since the concepts of the two types of plans are not similar. ERISA provides what is known as the 1.4 rule for solving this problem. This rule provides that no more than 140% of the total allowable limitations may be provided for all plans combined. In other words, if the full $75,000 (as adjusted) of benefits is provided under a defined benefit plan, then only 40% of the allowable contributions can be provided under all defined contribution plans. Using the figures from September 2, 1974, the aggregate annual addition that may be made to any participant’s account would be, in this example, $10,000 (40% of $25,000). A defined benefit plan must spell out specifically, as a limitation, the 1.4 rule.

Another new concept of the 1974 pension laws was the “minimum funding standard account.” As defined in section 412(b), the account is, in the case of money purchase plans, simply the amount which the employer has promised to contribute. A credit to the account will be made for excess contributions which are carried over from prior years. In the event that a deficit should occur in the account, the employer is subject immediately to a 5% excise tax and subject potentially to up to a 100% excise tax. This is materially different from earlier years when an employer, experiencing financial difficulties, simply would miss a pension contribution. The law does provide for postponement of the requirement for funding with the permission of the Secretary after demonstration of substantial business hardship.

As a final word on contribution limitations to defined contribu-

35. I.R.C. § 415(e)(1).
37. I.R.C. § 412(b).
38. I.R.C. § 4971.
tion plans, a change has been made concerning the maximum amount deductible in carryover years. It may be recalled that prior to 1974, in a year to which a contribution carryover was applicable, the employer was allowed a maximum 30% deduction. Code section 404(a) has been amended, and section 413(b)(7) has been added eliminating the 30% limitation and instead providing a 25% aggregate limitation. In the case of profit-sharing plans, the maximum annual 15% deduction for contributions remains unchanged.

Benefits

After establishing which employees must be participants and the level of contributions to be made on their behalf, the drafter of a post-ERISA plan must determine the nature of benefits to be provided. Prior to 1974, this area of the law was most ambiguous. The regulations required that the plan must be for the participant’s retirement and that such deferred benefits as an interest only option could not be provided. Similarly, benefits could not be so heavily shifted to the survivor of a joint and survivor annuity or to a beneficiary so as to reduce substantially the lifetime benefits of the employee-participant. On the other hand, in order to qualify, a plan had to defer compensation. Benefits therefor were required to be postponed until some time in the future.

While ERISA has not legislated specifically in all benefit areas, now a plan must specify certain aspects as to when and how benefits are to be provided. First, the new law spells out the latest starting date for provision of benefits. Payment of benefits are required to commence no later than sixty days following the last day of the plan.

40. I.R.C. § 404(a)(7), amended by ERISA. Pre-ERISA law allowed current year’s contributions plus carryover year contributions to be deducted in an amount not to exceed 30% of compensation in the year to which the carryover contributions were carried. Thus, an effective 30% contribution level could be achieved after the first year of the plan.


43. Rev. Rul. 62-195, 1962-2 C.B. 125. It is common practice for District Directors’ Offices to require the boiler plate type language for a qualified plan: no interest only option and no annuity option providing for distribution slower than under an annuity policy issued at age 65 with benefits paid for life, with guaranteed payments for 20 years, may be selected, and provided further that any difference in the amount of the vested portion of a participant’s account and the cost of the annuity contract shall be paid to the participant or his beneficiary in cash.

44. Treas. Regs. § 1.401-11(e).

45. Treas. Regs. § 1.401-1(b)(ii) (pre-ERISA).

year during which a retiring participant attains normal retirement age (65 if earlier), dies or is totally and permanently disabled. To balance things out, the plan, to qualify, must provide that if a participant terminates for reason other than retirement, death or total and permanent disability and does not consent to distribution of benefits in excess of $1,750 (as may be adjusted by regulation), the employee may not be required to accept a current distribution of benefits.47

The major change imposed by ERISA in the area of benefits to be provided is the preference given joint and survivor annuities. The Code requires each qualified plan which provides for benefits in annuity form to contain a provision that mandates the payment of a joint and survivor annuity unless the participant elects otherwise.48 The plan must allow the participant to make an election not to take a joint and survivor annuity. The election must be in writing and within a reasonable time before the annuity’s starting date. If the participant does not affirmatively elect otherwise, a joint and survivor annuity will be paid and the surviving spouse’s annuity must be at least one-half of the amount paid to the participant during the joint lives of the annuitants.49

VESTING

In most cases a substantial period of time elapses between the making of the contribution on behalf of the participant and the departure of that participant with retirement benefits. A dichotomy of thought has existed for many years regarding proprietary rights to those benefits during that interim period. If an employee-participant has earned benefits for which the employer has been granted a deduction over a period of years and the employee has not yet reached retirement age at the time his service is terminated, has that participant any vested rights in those benefits?

Pre-1974 rules were most general and were specifically criticized in the ERISA Committee reports. The IRS conceded that the statute did not require vesting at all and ruled to that effect. Revenue Ruling 65-17850 clarified vesting requirements in the following language: "(c) Vested Benefits. Various provisions are in use, ranging from complete and immediate vesting through different

47. I.R.C. § 411(a)(7)(B). If there will be a cash distribution on termination of a plan and the interest of a participant is refused, the participant can be given a paid up annuity.
forms of graduated vesting, upon completion of stated service or participation requirements and, or, reaching a specified age, to no vesting until attainment of normal or stated retirement age." Nevertheless, even pre-ERISA law required plan contributions to be for the benefit of the employee-participants. Using this broad framework, the Service raised the possibility of discrimination in operation of plans providing slow vesting or no vesting at all. The uncautioned favorable determination letter was used as a club to impose requirements that could be said to have sprung only from the conscience of the respective District Directors' Offices. By way of example, some offices were moving toward a position (informally) that vesting was a function of the number of key employee-participants. This was particularly true in the case of professional service corporations. The fewer the number of professionals, the faster the rate of vesting that was required. Other offices did not take this position and were granting favorable determination letters without caveat in the case of small professional service corporations which provided very little vesting for an extended time.

Even if a rapid rate of vesting were provided in a plan, pre-ERISA law allowed divestiture for cause. An employee might find that his earned retirement benefits were denied to him in the event he was discharged for alcohol or drug abuse, for dishonesty or for accepting employment with a competing employer. These terms were defined poorly, and it does not take a great deal of imagination to foresee potential abuse. A recent case allowed total divestiture for accepting employment with a competitor without first obtaining the permission of the employer.

Perhaps more than in any other area of the law, ERISA serves to eliminate the veritable quagmire of inconsistent and often abusive vesting practices and requirements. Most uncertainties have been eliminated, and an employer preparing a plan knows what the permissible alternatives are. First, the "bad boy" or divestiture for cause provisions are forbidden in a qualified plan. Next, the law specifically spells out what service must be included in whatever vesting schedule is adopted. It was common practice prior to ERISA to include only service while a participant in the plan. A qualified plan now must include all service with the employer except as follows:

1. Service before attaining age 22 (provided, however, that if the ten-year or five-to-fifteen-year vesting schedule described below

is not used, the plan may not disregard any year of service during which the employee was a participant).

2. Service during the time that the employee declined to contribute under an employee contributory plan.

3. Service during the time the employer did not maintain a plan.

4. Seasonal and part-time service not constituting a year of service (year of service is described above).

5. Years of service before January 1, 1971, unless the employee had at least three years of service after December 31, 1970.

6. Years of service before the first plan year to which ERISA applies if the service would have been disregarded under the plan with regard to breaks in service as in effect on the applicable date. 53

The statute specifies four permissible methods of vesting. The first of these is the ten-year period of vesting described in section 411(a)(2)(A). It requires that a participant having at least ten years of service must have a nonforfeitable right to 100% of accrued benefits derived from employer contributions. 54

The next permissible method of vesting is contained in Code section 411(a)(2)(B) 55 and is the so-called five-to-fifteen-year vesting schedule. Under this method, a plan must vest the participant’s account in accordance with the following schedule:

<table>
<thead>
<tr>
<th>YEARS OF SERVICE</th>
<th>NONFORFEITABLE PERCENTAGE</th>
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<tbody>
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<td>5</td>
<td>25</td>
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<td>14</td>
<td>90</td>
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<tr>
<td>15 or more</td>
<td>100</td>
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A predecessor bill to the Employee Retirement Income Security Act of 1974 was much more limited in scope and failed to achieve

final passage. That bill incorporated a vesting schedule which was called the rule of 50. This provision was carried over and adopted in ERISA as the rule of 45 which now appears at section 411(a)(2)(C). In order to come within the ambit of the rule of 45, a plan must provide that a participant who has completed at least five years of service will be vested at least 50% when the sum of his years of service and age equals or exceeds 45.\[56\] Notwithstanding this limitation, a participant who has at least ten years of service must have a nonforfeitable right to at least 50% of accrued benefits regardless of age. After the participant is 50% vested, the statute provides a table of required vesting as follows:

<table>
<thead>
<tr>
<th>Years of Service Equal or Exceed</th>
<th>Sum of Age and Service Equals or Exceeds</th>
<th>Non-Forfeitable Percentage</th>
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<tbody>
<tr>
<td>5</td>
<td>45</td>
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<td>90</td>
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<td>10</td>
<td>55</td>
<td>100</td>
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</table>

All of the foregoing rules apply to plans providing for gradual accrual of vested benefits starting with the date of addition to a participant’s account. Some plans, however, provide for a differential vesting of benefits for each contribution. This is termed a “class year plan” under ERISA, and the vesting schedule may not exceed five years. Under this method of vesting, at any given point in time, a participant may have a different vested benefit in contributions attributable to different years.\[57\]

The Conference Committee reports under ERISA make it clear that the approved method of vesting establishes minimum standards only.\[58\] The Internal Revenue Service is not barred from requiring more stringent vesting schedules where appropriate. To maintain the desirable certainty in ERISA, the Committee reports conclude that the Internal Revenue Service may not require a vesting schedule greater than what commonly has been termed 4-40 vesting except in cases where actual misuse of the plan occurs in


\[57\] I.R.C. § 411(c)(4).

operation. Under this method, 40% must be vested after four years of service. Thereafter, 5% must be vested for each of the next two years and 10% for each of the next five years. The result is 100% vesting after eleven years of service. The IRS has announced that the 4-40 test would be applied universally unless a "key employee test" or a "turnover test" established by ruling was satisfied. This ruling, after substantial objection from the practicing bar, has been repealed substantially, and 4-40 vesting generally is not being required in order to obtain a favorable determination letter.

As previously noted, with certain exceptions, all years of service must be counted in determining the vested benefit of the participant in the plan. In this context, however, a totally new concept is introduced by ERISA. This is the "break in service." A break in service is deemed to have occurred when, during any twelve-consecutive-month period, the employee-participant is not credited with more than 500 hours of service. In applying the rules of vesting in cases where 100% vesting is provided within three years of service, an employee who has a break in service of one year and has not completed the service requirement prior to the break need not be credited with service before the break. For administrative convenience, if an employee has a one-year break in service, the plan may require a one-year waiting period before pre-break and post-break service must be aggregated under the plan.

In the defined contribution plan as defined in the statute, an employee who has a one-year break in service need not be credited for any increase in his vested percentage in pre-break benefit rules on account of post-break service. In all other plans once an employee has acquired any percentage of vesting, all his pre-break and post-break service must be aggregated for all purposes. An employee who has not acquired vested rights to an accrued benefit derived from employer contributions may lose credit for participation and vesting purposes when he incurs a number of years of consecutive one-year breaks in service equal to or exceeding the number of years of service before the break in service.

The break in service rules become very significant under the

64. I.R.C. § 411(a)(6)(C).
terms of section 411(a)(7)(C) of the Code. This provision requires that an employee who receives a cash distribution of nonforfeited funds must be given the opportunity, if rehired before a break in service has occurred, to repay to the plan the amount of benefits that the participant received, thereby causing restoration of benefits which otherwise would have been forfeited. This is to bring into parity situations where distributions have occurred, and situations where distributions have not occurred, with plan benefits postponed until a future date. From the standpoint of the small business, the likelihood of this provision coming into play is probably not too great. The qualified plan must contain these cash-out/buy-back restrictions. The employer, therefore, cannot be sure what benefits are actually forfeited by a terminating participant until a break in service has occurred. Good drafting practice is to reallocate forfeitures to other participants in the case of a profit-sharing plan or to reduce ensuing contributions of the employer in the case of a pension plan only after a break in service has occurred.

To round out the new vesting requirements, the new law requires 100% vesting of all employee benefits upon attainment of normal retirement age (age 65). Note that the statute explicitly states normal retirement age and not retirement date under the plan document. Thus a plan which provides for retirement at the end of the plan year during which the participant attains age 65 must provide for full vesting upon attainment of age 65 even if benefits are not payable until the end of that plan year. Employee contributions must be fully vested at all times.

ERISA goes one step further in protecting the benefits payable to employees. The act specifically requires that a qualified plan have a provision against assignment or alienation of participants' benefits. Normally entitled "non-alienation," this is similar in nature to spendthrift clauses inserted in other trust instruments.

**Fiduciary Responsibility**

Prior to the passage of ERISA, federal legislation largely confined itself to coverage, benefits, deductibility of contributions and taxability of distributions. A broad, ill-defined area of prohibited transactions existed with regard to the 501(c) exempt trust created under the plan. Some registration requirements existed under labor-

68. I.R.C. § 411(a).
70. I.R.C. § 401(a)(13).
related laws. Administrative provisions were developed largely by practice and custom with District Directors again using the determination letter to require equitable considerations. For years, anti-self-dealing legislation has existed for plans for self-employed individuals, but it was never applied to corporate qualified plans. The net result was that the relationship between the employer, the trustee and the plan was very fuzzy. It was not uncommon to see financial transactions between the two on a continuing basis. The lease of property owned by the plan to the employer was extremely common.

ERISA changed this area of the law dramatically. A whole new administrative system was established within the Department of Labor, and a set of laws applicable to the private pension system was imposed. These laws define the nature of the fiduciary relationship and the transactions that may occur between and amongst the various parties involved in plan administration. They further regulate investments and provide other safeguards for plan assets. Most of these requirements do not have to be incorporated into the plan document. The plan administrator, nevertheless, must be aware of their existence and must govern his activities accordingly.

The first requirement appears to be rather simple. This is the requirement that the plan be in writing. The written document must name an agent for the service of legal process, must name a plan administrator, and must state the identity of a “named fiduciary.” The act defines “fiduciary” as a person exercising any discretionary authority or discretionary control respecting the management or disposition of plan assets or rendering investment advice for a fee or other compensation or an individual exercising any discretionary authority or responsibility for the plan administration. A person may be within the definition of a “fiduciary” without being the named fiduciary in the plan document. Nonetheless, the document itself must name a fiduciary.

The plan administrator is the person charged with responsibilities of filing documents, making decisions under the plan itself, communicating with participants, etc. Often in the case of a small business, this position is held by the employer with a separate trustee. The fiduciary may be a participant. The Act goes on to prohibit persons convicted of certain crimes from holding any of these posi-

71. I.R.C. § 503(a).
72. Treas. Reg. § 1.401-1(a)(2); ERISA § 402.
73. ERISA § 502(d).
74. ERISA § 3(21).
tions of responsibility.75

Once designated, a fiduciary must be bonded unless otherwise exempt.76 The bond required is at least 10% of the amount of funds handled, but the bond need not exceed $500,000 unless specifically required by the Secretary of Labor. There are several exemptions from this bonding requirement, and generally professional fiduciaries such as banks and trust companies are exempt.77

In regulating the activities of fiduciaries, the labor provisions of the law specifically impose a prudent man rule.78 Generally, prior to ERISA, these rules were reserved for state trust laws. Under sections 404 and 407 of the Pension Reform Act, however, a fiduciary must carry out his duties with the care, skill, prudence and diligence which a prudent man acting in a like capacity would use under conditions prevailing at the time.

The definition of “party in interest” is necessary to fully comprehend the Labor Department provisions of the plan. That term is defined to include employers of plan participants; persons rendering services to the plan; unions whose members are plan participants, their officers and agents; officers, fiduciaries and employees of a plan; and relatives, agents and joint venturers of any of the foregoing.79

Section 406 of ERISA sets out a series of prohibited transactions generally designed to prevent a plan from dealing with parties in interest and to prevent the fiduciary from dealing with plan assets for his own benefit.80

Section 407 of the Act provides a 10% limitation on employer securities and qualifying employer real property.81 Generally speaking, individual account plans may hold qualifying employer securities and qualifying employer real property without limitation. The provisions of section 407 are designed to reduce past practices of using plan assets to provide a ready market for corporate stock and to provide physical facilities for the employer.

The law was drafted to continue to allow certain practices which were commonplace prior to ERISA and which involved direct dealing between parties in interest and the plan. A prime example of these practices is loans by the plan to plan participants. Section 0

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75. ERISA § 411.
76. ERISA § 412(a).
77. ERISA § 412(a)(2).
78. ERISA § 404(a)(1)(B).
79. ERISA § 3(14).
80. ERISA § 406.
81. ERISA § 407.
ERISA 49

408(b)(1) specifically allows such loans where the following requirements are met:

A. Loans are made available to all participants and beneficiaries on a reasonably equivalent basis.
B. Loans are not made available to highly compensated employees, officers or shareholders in an amount greater than the amount made available to other employees.
C. Loans are made in accordance with specific provisions set forth in the plan regarding such loans.
D. Loans bear a reasonable rate of interest.
E. Loans are adequately secured.

As with pre-ERISA plans, there is no reason to prevent the employee’s vested interest in the plan from providing security for the loan as long as a current distribution does not occur.

Prior to ERISA, the only real avenue of attack for violation of the prohibited transaction rules was disqualification of the plan. This was often not a palatable solution since it had the effect of generally causing the termination of the plan and the loss of substantial benefits to innocent rank and file plan participants. The new law substantially changes this procedure by the enactment of Code section 4975. This section imposes an excise tax on prohibited transactions. The tax is equal to 5% of the amount involved in the transaction and is imposed for the taxable year of the transaction and for each subsequent year (or a portion thereof) while the error is not corrected. The party in interest may be subject to an additional 100% excise tax if the prohibited transaction is not corrected after notice from the IRS.

In addition to the excise tax, the fiduciary standards provisions of ERISA provide for criminal penalties of fines of up to $5,000, imprisonment for not more than one year or both in the case of intentional violations and also provide for civil liability of fiduciaries who breach their fiduciary responsibility.

Section 410(a) of the Act prevents avoidance of the fiduciary responsibility laws through exculpatory provisions in the plan. Under that section, exculpatory provisions in an agreement that relieve, or purport to relieve, a fiduciary from liability for breach of the fiduciary responsibility rules are void. Regulations issued by the Department of Labor make clear that this requirement does not

82. ERISA § 408(b)(1).
83. I.R.C. § 4975.
84. ERISA §§ 501, 502.
85. ERISA § 410(a).
prohibit indemnification of a fiduciary by a third party. The employer, therefore, may purchase insurance to protect the fiduciary from liability under the fiduciary standards provision or may enter into an agreement to reimburse the fiduciary for any liability incurred.86

REPORTING AND DISCLOSURE

One area of major concern to the drafters of ERISA was the quantity of information flowing to participants. Prior to specific legislation, the information going to plan participants varied from extremely attractive gilt-edged annual certificates and printed booklets to virtually no information at all. The IRS required that the salient features of a newly installed plan be communicated to employees. After that the requirements were extremely vague and often employees, whether plan participants or not, knew little about the benefits they were accruing.

Alternatives for providing information to plan participants no longer exist. A very specific pattern of information is required to be supplied, and often participants find themselves with more information than they really care to have. Upon initial submission of the plan to the Internal Revenue Service for a letter of determination, each employee must be notified of his right to participate in the submission process, to comment upon plan provisions and to request the Department of Labor to comment.87 The regulations provide for distributing or posting of this notice so that all employees are informed adequately. A specific series of dates for comment must be identified in the notice.88 The Department of Labor has prepared a sample notice which can be used in most cases.

Section 102 of the Act details the requirements of a summary plan description which must be provided each plan participant.89 The summary plan description replaces the administratively imposed plan summaries required for a favorable letter of determination prior to the passage of ERISA.90 The summary plan description must be provided to plan participants by the later of ninety days after they enter the plan or 120 days after the plan becomes subject to ERISA reporting and disclosure requirements.91 Once issued, a

86. 29 C.F.R. § 2509.75-4 (1977).
87. ERISA § 3001(a).
88. Treas. Reg. § 601.201(D)(3) (proposed).
89. ERISA § 102.
90. Treas. Reg. § 1.401-1(a)(2) (pre-ERISA).
91. ERISA § 104(b).
summary plan description must be updated no less frequently than every ten years or, if there are plan amendments, every five years. Significant amendments must be described to participants within 120 days after they are made.\textsuperscript{92}

The summary plan description must supply, at a minimum, the following information:

1. Conditions which would disqualify a person from receiving benefits.
2. Plan provisions on eligibility for participation and on benefit vesting.
3. Identity of the plan’s administrator and agent for service of process.
4. Description of relevant portions of any applicable collective bargaining agreement.
5. Source of the plan’s financing and identity of any organization through which benefits are provided.
6. Date when the plan year ends and plan’s record-keeping method.
7. Description of the plan’s claims procedures and remedies if claims are rejected.

In addition, the regulations require that the summary plan description contain a statement of ERISA rights.\textsuperscript{93} A basic form is provided by the Department of Labor which customarily is incorporated into the summary plan description.\textsuperscript{94} Further, the summary plan description must state that plan participants have a right to examine the plan documents on the employer’s premises at convenient locations and times and to have copies of plan documents made at a reasonable cost.

Perhaps the most controversial reporting and disclosure requirement of ERISA is that the plan description be written in language calculated to be understood by the average participant. This requirement has resulted in summary plan description booklets with cute pictures of the fiduciary and plan administrator in sailor hats at the helm of the retirement benefits ship and in plan description language calculated to be understood by the average first grader. It may be suggested that drafters of summary plan descriptions pursue a policy of reasonableness. Summary plan descriptions can be cast in conversational language avoiding quotations from the regulations’ overly complex language.

Once completed, the summary plan description must be filed

\textsuperscript{92} Id.

\textsuperscript{93} 29 C.F.R. § 2520.102-3 (1977).

\textsuperscript{94} Id.
with the Department of Labor in Washington. No form for filing is specified, and it is common practice simply to mail the plan description, return receipt requested.

Once participants are supplied with their summary plan descriptions, they are entitled to annual financial reports on the progress of the plan and on their accounts. This "summary annual report" must be provided each participant within nine months after the close of the plan's year. If an extension of time to file forms 5500 or 5500-C is granted, the summary annual report need not be furnished until two months after the close of the extended period.

The summary annual report is required, by regulation,\(^95\) to provide plan participants with at least the following information:

1. Name of the plan.
2. Name of the employer.
3. Name, address and telephone number of the plan administrator.
4. Statement of assets and liabilities presented at current value.
5. A statement of income and expenses.
6. Notes to financial statements.
7. Notice to plan participants that they may obtain more detailed financial information concerning substantial transactions, transactions with a party in interest, etc.

Small plans which are entitled to file form 5500-C may comply with the summary annual report requirements simply by supplying plan participants with a copy of the form 5500-C without schedules and with a statement concerning their rights to additional information.\(^96\)

For the small plan, once the hurdles of the summary plan description and initial summary annual report are passed, filing and disclosure requirements become relatively simple. Combination forms 5500 or 5500-C are filed with the Department of Labor and Internal Revenue Service. As previously indicated, form 5500-C can be used as a form of summary annual report.

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\(^95\) 29 C.F.R. § 2520.104b-10 (1977).
\(^96\) 29 C.F.R. § 2520.104b-10(c)(2) (1977). Such statement shall read as follows:

Plan participants and beneficiaries may obtain copies of the following more detailed annual report information for a reasonable charge or inspect without charge: the latest, full annual report, including a list of certain party-in-interest transactions. To obtain a copy of any documents listed, write to the administrator asking for exactly what you want. The administrator will state the charge for specific documents on request, so that you can find out the cost before ordering. All documents listed can be examined at [state locations where documents may be examined].
FUNDAMENTAL CHANGES

After the plan has been established and is functioning, the plan administrator needs to be aware of the impact that certain fundamental changes in underlying statutory laws will have on the administration of the plan. By way of example, prior administrative practice described at Revenue Ruling 71-446 prohibited the plan from using increased Social Security benefit levels or wage base to reduce the benefits paid to retired employees already receiving benefits as well as to separated employees with nonforfeitable rights. ERISA has codified this practice at section 401(a)(15), and a qualified plan must specifically reference this limitation.

As required prior to ERISA, the new law provides that benefits need to be fully vested upon termination of the plan. Section 411(d)(3) of the Internal Revenue Code now provides that benefits must be fully vested on partial termination of the plan. In addition, in the case of a profit-sharing plan, benefits must be fully vested on complete discontinuance of contributions. The latter requirement does not apply to plans to which the minimum funding standards are applicable since the excise tax is imposed to cover this eventuality.

Section 401(a)(12) of the Code governs the circumstances of a merger or consolidation of employers with a concomitant merger or consolidation of plans. Each qualified plan must provide that in such an eventuality the participant would be entitled to a benefit after the merger which is at least equal to the value of the benefit he would have been entitled to before the merger. In computing these benefits, the before and after situations are determined as if the plan had been terminated.

HR-10 PLANS

In 1962 the Self-employed Individuals Retirement Act, or HR-10 as it has become commonly known, was enacted in order to provide a system of private retirement benefits for self-employed individuals. Since its passage it has been obvious that HR-10 plans were so vastly different from other qualified retirement benefit plans that there is really no comparison. Often, qualification for a corporate retirement plan was the principal factor in deciding whether to incorporate a business or not. Prior to ERISA, HR-10

plans had a maximum contribution limit of 10% of earned income or $2,500\textsuperscript{101} and had no provisions for an estate tax exclusion or any special tax benefits on lump sum distribution. A bank trustee was mandatory, and defined benefit retirement plans were not available.

ERISA and post-ERISA legislation has changed most of these provisions and made HR-10 plans, if not the equivalent of, at least comparable to corporate employee benefit plans. ERISA increased the contribution limitations to the lesser of 15% of earned income or $7,500 with a possible minimum deduction equal to the lesser of 100% of earned income or $750.\textsuperscript{102} An overall limitation of $100,000 has been established on earned income for purposes of determining limitations on contributions.\textsuperscript{103} Post-ERISA HR-10 plans qualify for estate tax exclusion in much the same manner as qualified corporate plans.\textsuperscript{104} Lump sum distributions are entitled to preferential tax treatment as in the case of corporate plans.\textsuperscript{105}

It was specifically ERISA’s intention to allow for non-bank trustees of HR-10 plans and to permit the use of defined benefit retirement plans for self-employed individuals. Regulations now allow both of these alternatives, but it is obvious that the IRS disfavors the former. Regulations issued regarding non-bank trustees of HR-10 plans are not really of much help. Large institutional managers other than banks can qualify now; and many, such as the major brokerage houses, are making use of these regulations. If an individual is trustee, under the regulations he or she probably will have to demonstrate great wealth, integrity and perhaps most difficult, immortality. One must wonder whether the will of Congress is being carried out in this area.\textsuperscript{106}

\textsuperscript{101} I.R.C. § 404(e), amended by ERISA.
\textsuperscript{102} I.R.C. § 404.
\textsuperscript{103} I.R.C. § 401(a)(17).
\textsuperscript{104} I.R.C. § 2039.
\textsuperscript{105} I.R.C. § 401(a).
\textsuperscript{106} Treas. Reg. § 11.401(d)(1)-1 requires that a non-bank trustee demonstrate to the satisfaction of the Commissioner that the manner in which he will administer the trust will be consistent with the requirements of I.R.C. § 401. Such demonstration must be made upon written application and satisfy the following requirements as to fiduciary ability:

1. Continuity - assurance of uninterrupted performance notwithstanding death or change of owners and sufficient diversity.
2. Established location.
3. Fiduciary experience.
4. Fiduciary responsibility.
5. Financial responsibility including net worth in excess of the greater of $100,000 or 4% of the value of the assets held, etc.
Prior to the passage of ERISA, the pension laws, when compared with other provisions of the Internal Revenue Code, constituted a veritable desert of anagrams. Although not specifically identified in the committee reports, it was obviously Congress' intention to rectify this situation by the passage of ERISA. In addition to such household words as ERISA itself, ESOP, PBGC (saying it as an anagram isn't easy), SPD, etc., the Pension Reform Act brought us IRA. IRA stands for individual retirement account. This is an entirely new concept in retirement planning codified at sections 219, 408 and 409 of the Internal Revenue Code.

An IRA is designed for persons who otherwise are not covered by qualified retirement benefits such as corporate plans or HR-10 plans. Such an individual, or his employer, may contribute up to the lesser of 15% of compensation or $1,500 to a qualified IRA. None of the participation or vesting provisions of ERISA apply to IRA's since they are on an individual basis only and may be discriminatory. All interest of individuals in the account must be nonforfeitable at all times. The fiduciary is required to be a bank or other suitable person as determined by the Secretary of the Treasury. No part of the funds are allowed to be invested in life insurance contracts. Legislation subsequent to ERISA has allowed for IRA's for persons who will receive future military retirement benefits and for spouses of persons qualified to participate in the IRA.

IRA's were intended to correct one additional problem of pre-ERISA law: the tax levied on lump sum distribution to persons not ready for retirement. Under ERISA as modified by the Revenue Act of 1978, an IRA can be used for a tax-free rollover. An individual receiving a lump sum distribution from a qualified plan may reinvest all or a portion of the distribution in a qualified IRA within sixty days after receipt and avoid current taxation. The same is true for distribution made within one taxable year not qualifying as lump sum distribution but made at the termination of a plan or at the receipt of a lump sum distribution from a qualified plan by a surviving spouse of plan participant.

Once established, funds constituting an IRA account are treated in much the same fashion for tax purposes as an HR-10 account.

108. Id.
110. I.R.C. § 408.
A GAGGLE OF IRA'S

In an attempt to simplify retirement planning even further, Congress, in the Revenue Act of 1978, provided for employer qualified plans using the IRA concept. The result is essentially a gaggle of IRA's, one for each of the employee-participants. Concepts drawn from both the IRA and the HR-10 plan have been aggregated to constitute this type of benefit.

The 1978 amendment allows a maximum contribution of the lesser of 15% of compensation or $7,500 on behalf of any participant in this simplified plan. The plan incorporates general rules of nondiscrimination in favor of officers, shareholders of self-employed individuals and further requires a definite and written allocation formula.

As with the normal IRA, all employee benefits must be vested. The allocation formula, nevertheless, may provide for a minimum entry age of twenty-five and performance of services on behalf of the employer in at least three of the preceding five calendar years. Contrary to the general rule for IRA's, participation in this type of plan is not precluded by participation in another qualified retirement plan.

The underlying rationale of the simplified pension plan is that an employer will establish a method of contribution, coverage, etc. in much the same fashion as if it were establishing a regular qualified plan. To ease the burdens of administration, however, the employer will have no further fiduciary or other responsibilities once the contribution is made. The relationship then will be among the employee-participant, his or her beneficiary and the corporate fiduciary. The employer will treat the contributions as solely the property of the employee-participant and will not have to worry about the complexities of such things as break in service, vested benefits and fiduciary responsibilities.

DECLARATORY JUDGMENT

For many years, the Internal Revenue Service has used the determination letter as a club to coerce the institution of certain plan provisions where the legal requirements were not precise. From a practical standpoint, this club was a formidable weapon. There is not now nor has there ever been a requirement that a qualified plan be submitted to the IRS for a letter of determination. Nevertheless,

111. I.R.C. § 408(j).
112. I.R.C. §§ 408(k)(3)(A), 408(K)(5).
the practice of submitting the plans and of obtaining a letter from the District Director's Office stating that the plan meets requirements for qualification and that the trust is exempt from taxation has developed over the years. Each employer wants one of these letters in his files to show an auditing agent who might scrutinize retirement plan contributions.

What was a plan sponsor to do if he submitted his plan for a letter of determination and the IRS verbally advised him that the plan did not qualify? He was then put on notice that any contributions to such a plan might be challenged. He could withdraw his application for a letter of determination or he simply could wait and have an adverse letter of determination issued. In either event, the employer that wanted to stick to the plan submitted had only one method of final determination as to qualification. He had to make a contribution to the plan to take a deduction on his income tax return and to wait for the auditing staff either to challenge that deduction, to challenge the failure of the employee to include the contribution in income or to challenge the exempt status of the retirement trust. The case then could be contested in court as a protest to the disallowance or inclusion. Obviously, this was a hard way to fight the battle. If it turned out that the IRS was right, substantial financial penalties resulted.

ERISA added Code section 7476 to resolve this problem. It provides for a declaratory judgment procedure in the case of qualified retirement plans. That section requires the employer first to exhaust administrative remedies by applying for IRS approval. Once the application is submitted, the IRS has 270 days to hand down its determination, and the employer then has 90 days to file for a declaratory judgment before the Tax Court. This is not a tremendously expeditious procedure; but it is no slower than prior to ERISA, and it does not require the gamble of making the contribution and daring the IRS to do something about it.

**Pattern Practitioner Plans & Model Plans**

Most law firms handling a substantial volume of pension and profit-sharing plans have had the experience of routinely submitting the same forms for the plans of several different employers and the IRS has required different modifications to each plan to obtain a favorable determination letter. This exemplifies the lack of consistency previously discussed. It was not unusual for different examin-

114. I.R.C. § 7476.
115. I.R.C. §§ 7476(a), 7476(b)(3).
ers in the same IRS office to impose different requirements on employers. On March 17, 1976, the IRS issued procedures for what commonly has been termed the "pattern practitioner plan." Under this procedure a law firm could submit a plan for a "notification letter" with the intention that the plan would be used much in the same fashion as master plans are used by sponsoring banks, etc. Under Revenue Procedure 76-15, a sponsoring law firm may submit up to two defined benefit, defined contribution or profit-sharing plans. The firm must represent that it has a reasonable expectation that the pattern plans will be adopted by more employers. The request for a pattern practitioner notification letter must be in conjunction with a normal employer's submission for a client.

The request must contain a pattern plan separate from the employer's plan that is being submitted for qualification. The separate pattern plan would contain blanks for all variables allowed the adopting employer. Once a favorable determination letter is issued with regard to the pattern practitioner plan, such plan may be adopted by additional employers who would then submit for qualification based upon their employee census and individual facts without reference to the detailed terminology in the plan.

To simplify adoption of a qualified retirement plan even further, the Internal Revenue Service has issued its own model plans. These plans, IRS forms 5612, 5613, 5614 and 5615, may be used either to amend existing plans or to adopt new plans. The model plans are for corporate employers and therefore cannot be used by persons desiring to adopt a self-employed retirement plan or an IRA. If adopted in their entirety, the model plans can be qualified through the IRS by a simple certification procedure rather than the more lengthy informal determination letter process.

**Simplified Filing**

The vast majority of qualified retirement plans involve small businesses with relatively few employees. The aspect of ERISA which caused most concern to practitioners was the series of complex filing requirements with both the Internal Revenue Service and the Department of Labor. Those representing small businesses could foresee horrendously burdensome administrative costs that potentially could spell the doom of the small plan.

The Internal Revenue Service as well as the Department of Labor realized the potentially adverse consequences of reporting requirements and took action to consolidate required forms and to

ease the burden of the small plan.

After several abortive drafts, the Department of Labor developed a form EBS-1 (plan description) which must be filed with the Secretary of Labor within 120 days after a plan becomes subject to the reporting and disclosure requirements of ERISA. The EBS-1 form, initially a monster of complexity, is now a relatively simple form which should give the plan administrator few problems.

The same series of events surrounded the adoption of an annual reporting system to the Department of Labor and to the Internal Revenue Service. It first was contemplated that different forms would be required to be completed and to be filed separately at each of the administrative agencies. This problem has been resolved by the completion of the various forms 5500. They provide for a single annual filing for both of the administrative agencies and allow for form 5500-C where the sponsoring plan has fewer than 100 participants. As previously indicated, in order to simplify the procedures, the first two pages of form 5500-C can be used as the summary annual report. Plan sponsors that may file form 5500-C also are exempt from the annual requirement of certification by a certified public accountant.

The 5500 series of reporting forms has replaced pre-ERISA forms 990-B, 4848, 4848 Schedule A and 4849. A comparison of these documents will reveal that post-ERISA filing requirements are shorter, simpler and easier to handle than their pre-ERISA predecessors. One change is the penalty for failure to file. The law now allows for a penalty of up to $10.00 per day for failure to file the required forms on time.

**Conclusion**

Enough time has elapsed to permit the examination of ERISA in retrospect: to view it in light of what it was intended to do and what it actually has done. After many years the statute was brought up to date with the complex regulatory framework and the immense retirement system it was designed to govern. It indeed would be a miracle if such a gigantic step were accomplished with facility and were accepted immediately by the people regulated. Such easy reform does not occur often. It did not happen when the private foundation rules were changed substantially in 1969 or when the estate tax laws were overhauled in 1976.

The need was nevertheless there. Pre-ERISA law bestowed tax benefits upon those maintaining private retirement programs. Obviously, Congress had concluded, as a matter of social policy, that taxpayers should encourage such a private retirement system. Basi-
cally, however, the law stopped there. It did not define the entity entitled to such benefits; it gave little guidance as to who among the employees must be covered, and it provided few limitations on contributions and benefits. Perhaps most importantly the law failed to intervene in protection of the rights of employee-participants. A private pension system is designed to encourage the payment of retirement benefits to the broad cross section of workers and thus to supplement social security payments. It is hard to imagine how these goals are being accomplished when, for example, a rank and file participant is denied benefits for securing employment with a competing employer or is discharged shortly before attaining normal retirement age with no vested benefits.

As previously indicated, administrative requirements in the regulations, in the rulings, in Isidore Goodman commentaries and in the requirements of each District Director attempted to correct pre-ERISA shortcomings. The result was a patchwork quilt of inconsistent rules often of dubious validity.

ERISA and subsequent legislation represents a genuine attempt on the part of the Congress to meet its responsibilities, previously simply dumped on administrative agencies. There is no doubt that this has resulted in overkill to some degree. As with other legislation, there is a need for congressional oversight review and benign administration during the period of absorption. This is occurring. The Williams-Javits Bill introduced in Congress and the President's ERISA Reform Directive appear to be moving in the right direction. Nevertheless, scare stories concerning the horrors of administration continue to appear in print, and supposedly knowledgeable commentators rue the day that ERISA was passed.

The practicing Bar must recognize that ERISA represents the coming of age of pension and profit-sharing legislation. For us to react to the complexities by abandoning this extremely important planning tool is to do a disservice to our clients and to the broad cross section of working people who so badly need this supplement to what may well be woefully inadequate social security benefits.