COLUMN

Plan Distributions

The IRS Issues Further Guidance On the "Same Desk Rule"

By MELANIE N. ASKA KNOX

The Internal Revenue Service has issued further guidance on whether the same-desk rule will be applied to bar distributions from 401(k) plans, including Revenue Ruling 2000-27 and a host of recent private letter rulings.

In Revenue Ruling 2000-27 [2000-21 I.R.B. 1016 (May 22, 2000)], the Internal Revenue Service (IRS) has refused to apply the same-desk rule and ruled that employees who terminated employment when their employer sold less than 85 percent of its assets to an unrelated company, which rehired most of them to continue to perform their same jobs, had indeed incurred a "separation from service" and therefore could receive distributions from their former employer's 401(k) plan. Thus, it would appear that, at least in *some* cases involving sales of assets that themselves do not qualify as 401(k)(10) distribution triggering events (for example, because less than 85 percent of the assets of a separate trade or business is being sold, or because one or more of the other technical requirements of the applicable Treasury regulations have not been met), 401(k) plan sponsors nevertheless may distribute the account balances of their former employees who are associated with the transferred assets, owing to their separation from the service of the company whose assets have been sold.

Revenue Ruling 2000-27 also contains a transition rule that applies to any pre-September 1, 2000 sale of less than 85 percent of the assets of a trade or business and that provides that the IRS will not treat the selling employer's 401(k) plan as failing to follow its provisions merely because the employer does not treat the termination of employment from the seller and the hiring by the buyer as a "separation from service" within the meaning of Section 401(k)(2)(B) of the Internal Revenue Code (Code) and, therefore, does not permit distributions from the plan to the terminated employees hired by the buyer.

Also, in recent private letter rulings (PLRs), including PLRs 200024056 (3/21/00), 200019045 (2/14/00), and others described below, the IRS has opted not to apply the same-desk rule, under a broad range of facts and circumstances and has allowed 401(k) distributions to be made to participants who kept working at their same jobs after the various business transactions that affected them had occurred.

However, in another set of recent PLRs, including PLRs 200027059 (4/11/00), 200019048 (2/18/00), and others described below, the IRS has opted to apply the same-desk rule, under similar facts and circumstances and did *not* allow 401(k) distributions to be made to participants who kept working at their same jobs after the business transactions that affected them had occurred.

This article summarizes the 401(k) distribution triggering event rules and focuses special attention upon the recent spate of guidance from the IRS, including Revenue Ruling 2000-27 and recent PLRs, concerning the application of the same-desk rule to determine whether or not a "separation from service" distribution-triggering event has occurred.

GENERAL 401(k) DISTRIBUTION RESTRICTIONS

Distributions from 401(k) plans are subject not only to the Code and ERISA rules that govern qualified plan distributions generally (for example, the minimum required distribution rules of Code Section 401(a)(9)), but also to specific restrictions, under Code Sections 401(k)(2)(B) and 401(k)(10), that further limit the distribution of elective contributions, qualified nonelective contributions (QNECs), qualified matching contributions (QMACs), and attributable earn-

Melanie N. Aska Knox, Esq., is a Shareholder with Godfrey & Kahn, SC, Milwaukee, WI.

ings. These additional distribution restrictions do not apply to other funds held under a 401(k) plan (for example, the employer's profit-sharing contributions and matching contributions, and attributable earnings, provided that these contributions are not QNECs or QMACs, respectively), if they are accounted for separately. The portion(s) of a participant's account that are attributable to employer profit-sharing contributions (other than QNECs) and matching contributions (other than QMACs) may be distributed without regard to these additional distribution restrictions, provided they meet the regular rules for the distributability of amounts from a profit-sharing plan. For example, if the plan document permits distribution, the profit-sharing contributions and attributable earnings may be distributed when the participant terminates employment with the plan sponsor, after a specified number of years, or when he incurs a hardship (which does not have to meet the special Code Section 401(k) definition of hardship).

The special distribution restrictions of Code Sections 401(k)(2)(B) and 401(k)(10) provide, in part, that amounts that are attributable to elective contributions, QNECs, and QMACs may not be distributed to participants or beneficiaries earlier than

1. Separation from service, including retirement [I.R.C. § 401(k)(2)(B)(i)(I); Treas. Reg. § 1.401(k)-1(d)(1)(i)];
2. Death [I.R.C. § 401(k)(2)(B)(i)(I); Treas. Reg. § 1.401(k)-1(d)(1)(i)];
3. Disability [I.R.C. § 401(k)(2)(B)(i)(I); Treas. Reg. § 1.401(k)-1(d)(1)(i)];
4. The attainment of age 59½ (in the case of a 401(k) arrangement forming part of a profit-sharing or stock bonus plan) [I.R.C. § 401(k)(2)(B)(i)(III)];
5. Hardship (in the case of a 401(k) arrangement forming part of a profit-sharing or stock bonus plan) [I.R.C. § 401(k)(2)(B)(i)(IV)];
6. Plan termination, unless a successor plan is established or maintained [I.R.C. §§ 401(k)(2)(B)(i)(II), 401(k)(10)(A)(i); Treas. Reg. §§ 1.401(k)-1(d)(1)(iii), (3)];
7. The disposition, by a corporation, of substantially all of its assets used in a trade or business, but only with respect to those employees who continue employment with the corporation acquiring those assets [I.R.C. §§ 401(k)(2)(B)(i)(II), 401(k)(10)(A)(ii); Treas. Reg. §§ 1.401(k)-1(d)(1)(iv), (4), (5), (6)]; or
8. The disposition, by a corporation, of its interest in a subsidiary, but only with respect to those employees who continue employment with the subsidiary [I.R.C. §§ 401(k)(2)(B)(i)(II), 401(k)(10)(A)(iii); Treas. Reg. §§ 1.401(k)-1(d)(1)(v), (4), (5), (6)].

The events listed in 1 through 8 above often are referred to as distribution-triggering events or distributable events. A 401(k) plan may distribute amounts attributable to elective contributions, QNECs, or QMACs only when such an event occurs, provided the plan document allows the distribution to be made under such circumstances.

RETIREMENT OR OTHER SEPARATION FROM SERVICE AS A TRIGGERING EVENT

A 401(k) plan may distribute amounts attributable to elective contributions, QNECs, or QMACs if a participant retires or otherwise "separates from service." [I.R.C. § 401(k)(2)(B)(i)(I); Treas. Reg. § 1.401(k)-1(d)(1)(i)] Neither Code Section 401(k) nor the related Treasury regulations provide any guidance for determining when a participant has incurred a "separation from service" covered by a 401(k) plan in the context of a merger, acquisition, or other business transaction. The IRS applies the so-called same-desk rule to determine whether a participant has indeed experienced a separation from service that would entitle him or her to receive a distribution of amounts attributable to elective contributions, QNECs, and QMACs from the acquired company's 401(k) plan.

Generally, under the same-desk rule, any participant who continues to perform the same job after a merger, acquisition, or other business transaction will not be treated as having separated from service, and, if there is no other triggering event (e.g., plan termination, or sale of assets or a subsidiary, etc.) permitting the distribution of elective contributions, QNECs, QMACs, and attributable earnings, no distribution may be made to the participant from his or her former employer's 401(k) plan.

In Revenue Ruling 79-336 [1979-2 C.B. 181], the IRS ruled that an employee will be considered separated from service only when he dies, retires, resigns, or is discharged, and not when he continues on the same job for a different employer as a result of the liquidation, merger, or consolidation of the former employer. In Revenue Ruling 80-129 [1980-1 C.B. 86], the IRS extended this rationale to situations where an employee of a partnership or corporation, the business of which is terminated, continues on the same job for a successor employer.

IRS Guidance Involving Separations from Service

In each of the following items of guidance, the IRS ruled that, under the relevant facts and circumstances, a separation from service that qualified as a 401(k) distribution triggering event *had* occurred (i.e., the same-desk rule did *not* prevent distributions).

- *Revenue Ruling 2000-27*. Employees who terminated employment when their employer sold less than 85 percent of its assets to an unrelated company, who rehired most of them to perform the same jobs they had performed for their former employer, nevertheless had incurred a separation from service that triggered distributions of their accounts from the former employer's 401(k) plan.
- *PLR 200024056* (3/21/00). Employees who terminated employment with a subcontractor, and who were rehired by the new primary contractor to continue their work on the same project, nevertheless, had incurred a separation from service that triggered distributions of their accounts from their former employer's 401(k) plan.
- *PLR 200019045* (2/14/00). Employees who were discharged when their employer terminated a joint arrangement with a co-venturer, and who were rehired by a third company in a new joint arrangement with the same co-venturer, to perform legal work that was unrelated to the ongoing business of their former employer had incurred a separation from service that triggered distributions from their former employer's 401(k) plan.
- *PLR 200008046* (12/3/99). Employees who terminated employment with a government contractor, and who were rehired by the U.S. governmental agency whose research contract with the contractor had expired, had incurred a separation from service that triggered distributions from their former employer's 401(k) plan.
- *PLR 200008045* (12/3/99). Same facts as PLR 200008046 (12/3/99).
- *PLR 200030031* (5/1/00). The IRS revoked PLR 200009047 and ruled that employees who were discharged when their employer's hotel management contracts were terminated, and who were rehired by the real estate investment trust (REIT) that had purchased the hotels and who thereafter continued to perform the same services at the hotels, had incurred a separation from service and could receive distributions from their former employer's 401(k) plan.
- *PLR 199931046* (5/10/99). Employees who were discharged when their employer's contract with a governmental agency was terminated, and who were rehired by the replacement contractor, a company unrelated to their former employer, to continue to perform the same facilities management services at a governmental facility, nevertheless, had incurred a separation from service that triggered distributions from their former employer's 401(k) plan.
- *PLR 199927048* (4/16/99). Employees who were discharged when their employer terminated its contract with a governmental health care financing administration, and who were rehired by an unrelated contractor to continue to perform the same work for the governmental unit, nevertheless had experienced a separation from service that triggered distributions from their former employer's 401(k) plan.
- *PLR 9835040* (6/2/98). Employees who were discharged when their employer's property management contract was terminated, and who were rehired by an unrelated company to perform the same services at the same property, nevertheless, had incurred a separation from service that triggered distributions from their former employer's 401(k) plan.

In each of the following PLRs, the IRS ruled that, under the relevant facts and circumstances, a separation from service *had not* occurred (i.e., the same-desk rule *did* prevent distributions).

- *PLR 200027059* (4/11/00). Employees who were discharged when their employer outsourced its information services operations, who were rehired by the unrelated corporation to whom the operations had been outsourced, and who thereafter continued to provide information services to their former employer under the outsourcing contract between their current and former employers, had not incurred a separation from service and could not receive distributions from their former employer's 401(k) plan.

- *PLR 200019048* (2/18/2000). Employees who were discharged when their employer ceased to perform its own data processing services, and who were rehired by an unrelated data processing company to perform the same data processing services for their former employer and one of its affiliates, had not incurred a separation from service and could not receive distributions from their former employer's 401(k) plan.
- *PLR 9848008* (9/4/98). Employees who were discharged when their employer sold its mill to an unrelated corporation that rehired them, and who continued to perform their same mill jobs, had not incurred a separation from service and could not receive distributions from their former employer's 401(k) plan.
- *PLR 9706017* (11/4/96). Employees who were discharged when their employer leased the retirement home facility at which they worked to an unrelated corporation who rehired them to continue to perform their same jobs at the facility had not incurred a separation from service and could not receive distributions from their former employer's 401(k) plan.

DEATH, DISABILITY, ATTAINMENT OF AGE 59½, OR HARDSHIP AS TRIGGERING EVENTS

A 401(k) plan also may distribute amounts attributable to elective contributions, QNECs, and QMACs when a participant dies or becomes disabled. Many 401(k) plans also allow such amounts to be distributed when a participant reaches age 59½ or experiences financial hardship. Even if a particular merger, acquisition, or other business transaction fails to give rise to a triggering event (such as separation from service, termination of a plan without a successor plan, or the disposition of assets or a subsidiary) with respect to some 401(k) plan participants, distributions of amounts attributable to elective contributions, QNECs, and QMACs nevertheless may be made from the plan (if it so provides) to other 401(k) plan participants who die, become disabled, reach age 59½, or experience financial hardship.

PLAN TERMINATION AS A TRIGGERING EVENT

A 401(k) plan also may distribute amounts attributable to elective contributions upon plan termination, but only if the employer does not establish or maintain a successor plan. [I.R.C. §§ 401(k)(2)(B)(i)(II), 401(k) (10)(A)(i); Treas. Reg. §§ 1.401(k)-1(d)(1)(iii), (3)] The term *employer* means the controlled group of employers as of the date of plan termination. [Treas. Reg. §§ 1.401(k)-1(d)(3), 1.401(k)-1(g)(6), 1.410(b)-9] A *successor plan* is any other defined contribution plan (other than an employee stock ownership plan (ESOP), defined in Code Section 4975(e) or 409(a), or simplified employee pension (SEP) plan, defined in Code Section 408(k)) maintained by the same employer, which exists at any time during the period beginning on the date the 401(k) plan terminates and ending 12 months after the date all assets have been distributed from the terminated plan. [Treas. Reg. § 1.401(k)-1(d)(3)] However, the employer's other defined contribution plan will *not* be a successor plan for these purposes if, at all times during the 24-month period beginning 12 months before the 401(k) plan terminates, fewer than 2 percent of the employees who were eligible under the 401(k) plan as of its termination date are eligible under the other defined contribution plan. [Treas. Reg. § 1.401(k)-1(d)(3)] Any distribution of amounts attributable to elective contributions, QNECs, or QMACs that is triggered by the termination of a 401(k) plan must be made in the form of a lump-sum distribution, and all consents or elections required under Code Sections 411(a)(11) or 417 also must be obtained. [Treas. Reg. §§ 1.401(k)-1(d)(5), (6)(v)]

Examples of PLRs Involving the Termination of a 401(k) Plan

In PLRs 199931047 (5/10/97), 199929048 (4/28/99), and 9729042 (4/24/97), plan terminations qualified as a 401(k) distribution-triggering event. However, in PLR 9523025 a partial termination is not a plan termination and does not qualify as a 401(k) distribution-triggering event.

SALE OF SUBSIDIARY OR ASSETS AS A TRIGGERING EVENT

A 401(k) plan also may distribute amounts attributable to elective contributions, QNECs, and QMACs if a corporation sells or otherwise disposes of substantially all of the assets it uses in a trade or business [I.R.C. §§ 401(k)(2)(B)(i)(II), 401(k)(10)(A)(ii); Treas. Reg. §§ 1.401(k)-1(d)

(1)(iv), (4), (5), (6)], or sells or otherwise disposes of its interest in a subsidiary [I.R.C. §§ 401(k)(2)(B)(i)(II), 401(k)(10)(A)(iii); Treas. Reg. §§ 1.401(k)-1(d)(1)(v), (4), (5), (6)], but only if the following requirements are met:

1. Seller must continue to maintain the 401(k) plan after the sale or other disposition. The selling corporation must continue to maintain the 401(k) plan after it sells or otherwise disposes of the assets or subsidiary. This requirement is met if and only if the purchaser does not maintain the 401(k) plan after the sale or other disposition. The purchaser maintains the selling corporation's 401(k) plan if (i) it adopts the plan or becomes a participating employer under the plan or (ii) the selling corporation's 401(k) plan is merged or consolidated with, or any assets or liabilities are transferred from such 401(k) plan to, a plan maintained by the purchaser. [Treas. Reg. § 1.401(k)-1(d)(4)(i)] However, the purchaser is *not* treated as maintaining the selling corporation's 401(k) plan merely because a plan that the purchaser maintains accepts either elective transfers or rollover contributions (including direct rollovers) from the seller's 401(k) plan. [Treas. Reg. § 1.401(k)-1(d)(4)(i)]

Note: In the case of the sale or other disposition of assets or a subsidiary, the *seller* of the assets or subsidiary must be a *corporation*. [Treas. Reg. §§ 1.401(k)-1(d)(1)(iv), (v)] In the case of a sale or other disposition of *assets,* the *purchaser* also must be a *corporation* and it must be unrelated to the selling corporation, that is, not a member of the same controlled group after the sale or other disposition. [Treas. Reg. §§ 1.401(k)-1(d)(1)(iv), 4(iv)(B)] However, in the case of a sale or other disposition of *an interest in a subsidiary,* the *purchaser* may be *any entity or individual,* but it must also be unrelated to the selling corporation. [Treas. Reg. §§ 1.401(k)-1(d)(1)(v), (4)(iv)(B)]

2. Distributions of amounts attributable to elective contributions, QNECs, and QMACs may be made only to those employees who continue to work for the purchaser. The selling corporation's 401(k) plan may distribute amounts that are attributable to elective contributions, QNECs, and QMACs only to a participant who continues to be employed by the purchaser of the seller's assets or with the subsidiary, whichever applies. [Treas. Reg. § 1.401(k)-1(d)(4)(ii)]

3. The distributions of amounts attributable to elective contributions, QNECs, and QMACs must be in connection with the sale or other disposition of assets or subsidiary. The distributions, from the selling corporation's 401(k) plan, of amounts attributable to elective contributions, QNECs, and QMACs also must be made "in connection with" the seller's sale or other disposition of its assets or a subsidiary that results in the employee's transfer to the purchaser. [Treas. Reg. § 1.401(k)-1(d)(4)(iii)] Whether a disposition is made in connection with the sale or other disposition of assets or a subsidiary depends on all of the facts and circumstances. [Treas. Reg. § 1.401(k)-1(d)(4)(iii)] However, except in unusual circumstances, a distribution will not be treated as having been made in connection with a sale or other disposition unless it is made by the end of the second calendar year after the calendar year in which the sale or other disposition occurs. [Treas. Reg. § 1.401(k)-1(d)(4)(iii)]

4. The purchaser must be unrelated to seller. In the case of a corporation's sale or other disposition of substantially all of the assets it uses in a trade or business, the purchaser must be an "unrelated" corporation. [Treas. Reg. §§ 1.401(k)-1(d)(1)(iv), (v), (4)(iv)(B)] In the case of a corporation's sale or other disposition of its interest in a subsidiary, the purchaser must be an unrelated entity or individual. [Treas. Reg. §§ 1.401(k)-1(d)(1)(v), (4)(iv)(B)] For these purposes, an unrelated purchaser is an individual, corporation, or other entity, as the case may be, that is not part of the seller's controlled group after the sale or other disposition. [Treas. Reg. § 1.401(k)-1(d)(4)(iv)(B)]

In the case of the sale or other disposition of substantially all of the assets used by a seller in a trade or business, both the seller and the purchaser must be corporations. [Treas. Reg. § 1.401(k)-1(d)(1)(iv)] In the case of the sale or other disposition of its interest in a subsidiary, the seller also must be a corporation, but the purchaser may be an entity (including a corporation) or an individual. [Treas. Reg. § 1.401(k)-1(d)(1)(v)]

5. Substantially all assets used in a trade or business must be sold or otherwise disposed of. This requirement applies only in connection with sales of assets, and not in connection with sales of subsidiaries. For purposes of the rule allowing distributions of amounts that are attributable to elective contributions, QNECs, and QMACs, upon a selling corporation's sale or other disposition of substantially all the assets used in a trade or business, "substantially all" means at least 85 percent of such assets. [Treas. Reg. §§ 1.401(k)-1(d)(1)(iv), 4(iv)(A)]

6. Lump-sum distributions required. Any distribution of amounts attributable to elective contributions, QNECs, and QMACs that is triggered by the sale or other disposition of assets or a subsidiary must be made in the form of a lump-sum distribution. [Treas. Reg. § 1.401(k)-1(d)(5)]

7. Required consents and elections must be obtained. Finally, all consents or elections required under Code Sections 411(a)(11) or 417 must be obtained before any amounts attributable to elective contributions, QNECS, or QMACs may be distributed in connection with a sale of assets or a sale of a subsidiary. [Treas. Reg. § 1.401(k)-1(d)(6)(v)]

Examples of PLRs Involving Sales of Subsidiaries

- *PLR 200005033* (11/8/99). Sale of subsidiary qualifies as a 401(k) distribution-triggering event.
- *PLR 199905034* (11/10/98). Transaction did not qualify as a sale of a subsidiary because the seller of the subsidiary was an individual, not a corporation and, therefore, did not qualify as a 401(k) distribution-triggering event.
- *PLR 9707029* (11/21/96). Transaction did not qualify as a sale of a subsidiary because the interests that the selling corporation retained in such subsidiary after the sale, that is, 58 percent of the subsidiary's shares and one third of the seats on the subsidiary's board of directors, were so substantial that the seller had not "disposed" of its interest in the subsidiary.

Examples of Guidance from the IRS Involving Sales of Assets

In numerous instances the IRS has found the sale of assets to qualify as a 401(k) distribution-triggering event.

- *PLR 200010058* (12/15/99). Hospitals sold by their corporate parent constituted a separate trade or business for purposes of applying the sale of "substantially all" (i.e., 85 percent) of the assets of a trade or business test.
- *PLR 199925045* (3/31/99). A like-kind exchange is a "disposition" of assets for purposes of the 401(k) distribution rules.
- *PLR 199905032* (11/9/98). A purchaser of assets that was organized as a limited partnership under applicable state law, but that had elected to be treated as an association taxable as a corporation for federal income tax purposes nevertheless would be treated as a "corporation" for purposes of the sale of assets rules.
- *PLR 9836028* (6/9/98). An exchange of assets is a "disposition" of assets for purposes of the 401(k) distribution rules.
- Additionally, the following PLRs demonstrate instances where the sale of assets qualified as a 401(k) distribution-triggering event: PLR 200019047 (2/16/00), PLR 200008047 (12/8/99), PLR 200008043 (12/2/99), PLR 199947037 (8/30/99), PLR 199939047 (6/3/99), PLR 199928039 (4/10/99), PLR 199920047 (2/26/99), PLR 9847035 (8/27/98), PLR 9844038 (8/6/98), PLR 9837034 (6/16/98), and PLR 9601051 (10/11/95).
- Several PLRs include an analysis of the "separate trade or business requirement": PLR 9816032 (1/23/98), PLR 9748038 (9/5/97), PLR 9740025 (7/7/97), PLR 9715017 (1/8/97), and PLR 9618025 (2/5/96).

However, in the following guidance, the sale of assets does *not* qualify as a 401(k) distribution-triggering event.

- *Revenue Ruling 2000-27.* The subject sale involved less than 85 percent of the seller's assets. However, the IRS ruled that, under the relevant facts and circumstances, the employees associated with the transferred assets had incurred a separation from service distribution-triggering event and could receive distributions from the seller's 401(k) plan. (See above.)
- *PLR 9848008* (9/4/98). A purchaser of assets that was organized as a partnership under applicable state law was not a corporation for purposes of the sale of assets rules, and consequently the sale of assets was not a distribution-triggering event.

CONCLUSIONS

The special restrictions that apply to distributions, from 401(k) plans, of amounts attributable to elective contributions, QNECs, and QMACs are highly technical and formalistic. Nevertheless, the IRS's existing published guidance about whether certain sales of assets, sales of subsidiaries, or plan terminations trigger distributions from 401(k) plans has been relatively clear and reasonable. The IRS's existing published guidance about whether separations from service trigger such distributions is a lot less straightforward. In recent PLRs, the IRS has reached opposite conclusions after it applied its same-desk rule to remarkably similar sets of facts and circumstances.

Revenue Ruling 2000-27 relaxes the same-desk rule and allows 401(k) plan distributions upon separation from service, provided only that the affected employees' old and new employers are engaged in different trades or businesses and that their old employer not continue to receive their services. Revenue Ruling 2000-27 is consistent, for example, with recent PLRs 200024056 (3/21/00) and 200019045 (2/14/00) (in which the IRS ruled that a separation from service *had* occurred), in which the old and new employers were unrelated and the affected employees no longer rendered services, in any capacity, to their old employer. Revenue Ruling 2000-27 also is consistent, for example, with recent PLRs 200027059 (4/11/00) and 200019048 (2/18/00) (in which the IRS rules that a separation from service had *not* occurred), in which the affected employees continued to perform services for their older employers. The IRS should consider discarding the same-desk rule in favor of a simpler rule that would treat employees as having incurred a separation from service whenever they change common-law employers. Such a rule would be much more logical and easier to apply, and would not unduly inhibit the portability of the affected employees' retirement savings.