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TAXATION TO INDIVIDUALS OF PENSION INCOME

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The panel will discuss the various taxes that apply to individuals receiving benefits from pension plans.

- Income tax
- Excise taxes (early, excess, minimum)
- Methods of deferring taxes
- Nonqualified plans

MS. DALE B. GRANT: For our presentation, we're very fortunate to have two people who are experts in the field of taxation. They are attorneys from the firm of Stroock & Stroock & Lavan, Mark Wintner and Abbey Keppler.

Before our speakers make their presentations, let me just make a comment about the broader context of this subject. At this session, we are going to cover four specific categories of taxation. We have income tax, which used to be the only thing that we had to worry about – whether somebody needed to take regular income tax or capital gains tax treatment. Now that's just one of four categories on the table. We have three different kinds of excise taxes: early distribution, excess distribution, and minimum distribution. We'll hear about methods of deferring taxes through rollovers, and bit about nonqualified plans. The thing that I wanted to bring up about the broader context of this, is that we're talking about employee taxation only, taxation of individuals. The impact of the taxation of individuals will very much be affected by, and interacts with, many other rules that we have to deal with, like 415 rules, and plan provisions, employer tax consequences. And we also even need to take into account consideration of the general tax rates and the fact that we have low tax rates now and they may someday be higher. So, when listening to this discussion, try to think of it in the context of some broader issues, and maybe we'll have time to get into a little bit of a discussion of that later. Right now, I'd like to introduce Mark Wintner for the first part of this discussion.

MR. MARK S. WINTNER: The last time I spoke to the Society of Actuaries on a related, but slightly different topic, the moderator, who I will hasten to say was an actuary, so he could get away with it perhaps better than I could, started off by saying that it's often said that there are three kinds of actuaries, those who can count and those who can't. Much the same, I suppose, could be said about tax attorneys, although most of the rest of the world – ever since I became a tax attorney and then ERISA attorney – keeps asking me every April whether or not it's busy season. For

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the first five years I used to tell them that it didn't affect me. Now I tell them it's busy season so I don't have to see them until May.

There are a lot of very specific rules in this area, and we will probably barely have time to touch on some of them. Recognizing the bigger picture, I guess you have two other bigger pictures. The largest picture is that, for pension actuaries, or pension attorneys, or pension consultants of any kind, there are a lot of rules, most of which are regulatory. That is, they tell us minimum participation rules, vesting rules, funding rules (something you would know better than I would), 415 limits, the types of things that sort of tell us what plans can and cannot do.

Then, we have what are the more traditional type of tax rules, the tax rules which go to an employer deduction, to the treatment of an employee trust while it accumulates monies towards a person's retirement income. We'll talk about the taxation of distributions when money comes out of the plan, which is really only one of three tax incidents. One is how you treat money going into a plan, one is how you treat it while it's in the plan, and the other is how you treat it coming out. In a rational system, the tax rules wouldn't be so important because you'd decide what you'd want to do with your retirement system, and you would build it from the ground up. But as we do with a lot of things in this country, the carrot and stick approach of the tax code has fashioned a lot of things. And in this particular area, there are certain tax benefits, far fewer than there would have been five years ago had we been speaking, but still some tax benefits which are attributes of qualified plan distributions. It's important to know them and understand them, especially when we talk about closely-held businesses, or tax-shelter-type of plans.

In the second part of this session, Ms. Keppler will focus on, among other topics, the excise taxes, which instead of being a benefit, are now a trap for the unwary, and have made it harder to thread the needle between getting the maximum benefits without tripping over the possibility of not getting the benefits, but indeed incurring excise taxes to boot.

We won't spend a lot of time on nonlump sum distributions because there aren't a lot of choices and there aren't a lot of options involved. The rules are kind of basic. In the real world, probably more benefits are paid out in nonlump sum distributions than lump-sum distributions. Traditionally, most defined benefit plans, whether they be single employer or multiemployer, do not offer lump-sum distributions. It's a plan design issue whether your plan does offer a lump-sum distribution, and it is traditional, I suppose, that all defined contribution or individual account plans offer it, but very few defined benefit plans offer it. If there's a rule of thumb with regard to defined benefit plans, it's probably that most large employer plans do not have lump sums available. Most smaller or mid-sized defined benefit plans may have them available. The basic rule is kind of straightforward. If you get a nonlump sum distribution, which can be any kind of life or joint and survivor annuity, or any payout over a period of years certain, then the recipient, ordinarily the participant, will be taxed in the year in which he receives the income. It almost sounds like I didn't say anything. What I did say, or at least implied in a negative sort of way is that if a person retires at 65 with a $10,000 a year annuity for life, he's taxed on the $10,000 a year as he receives it. He is not taxed on the present value of that annuity at 65 when he

retires, although we could say it's probably worth $100,000 or so. No, he only pays tax on it as he gets the money.

What happens if we want to purchase a commercial annuity in order to fund that benefit. Traditionally qualified plans can, instead of self-funding the benefit, go out and purchase a commercial annuity from an insurance company and use that to fund the benefit. The pension plan or the pension plan trustee can then either hold ownership to the annuity contract, and just make payouts as time goes by, or more commonly, make distribution of the individual annuity contract to the participant. If they do that from a qualified plan, then even though that annuity has a value, in this case let's say the same $100,000 that we discussed before, the $100,000 is not what is taxable in the year in which the annuity is distributed. Instead, just as if it were self-funded, the benefit is only taxable as it's received month after month, year after year. That is equally the case even if the annuity contract can be surrendered. If it is in fact surrendered, however, the now-retired participant not only has the right to surrender but invokes his right to surrender. That will accelerate the tax incidence and he will then be taxed on the full value of the annuity contract.

That is an important distinction between qualified plans and nonqualified arrangements. For those of you who deal with nonqualified arrangements, you may know that when your executive, who's typically covered by a nonqualified arrangement, reaches 65 and he's entitled through his supplemental executive retirement plan (SERP) or other nonqualified benefit to $20,000 a year or $100,000 a year, he would rather not sit around waiting for a change in control or perhaps the failure of the company over his remaining lifetime. So he asks for an annuity contract. Well, that's fine, but if it's in a nonqualified arrangement and the company – the employer goes and purchases the annuity and transfers ownership of the annuity contract to the participant, the participant will be taxed in the year of the receipt of that annuity contract on the full value of the annuity contract, the same $100,000, if we were talking about a $10,000 a year annuity. So we have a very stark contrast between the commercial annuity, being distributed out of the qualified plan arrangement, as opposed to the nonqualified arrangement.

If we move past commercial annuities, as we said, in the garden variety plan, the participant or the retired participant will simply be taxed as he receives the money. The only qualification that we have to add to all this is how do we treat nondeductible employee contributions? Not every plan has them. Most plans don't have them because I think the trend is away from them. But there are still a substantial minority of plans which do have either voluntary or mandatory nondeductible employee contributions. Now, we're not talking about 401(m) contributions here. Those are pretaxed and are treated just like employer contributions.

If you have a nondeductible employee contribution in a plan, the general rule is that since the employee did not get a deduction when the money went in, that is, he already paid tax on it, he'll get it back tax-free. The Tax Reform Act (TRA) of 1986 made some basic changes in how we treat that, or at least how we calculate it. Prior to TRA 1986, if you had a plan with nondeductible contributions, and if an employee wanted to take out a distribution consisting of his nondeductible contributions prior to reaching his retirement age or termination of employment or death (in effect, an in-service distribution), then he was able to earmark the funds and say that the first

dollar he got out came out of those nondeductible contributions, and therefore they would be tax-free to him. TRA 1986 changed that very fundamentally. Under TRA 1986, there's a proportionality rule – if you have a plan with the nondeductible employee contributions and an employee takes an in-service distribution prior to his termination or other distribution event then for each dollar of distribution that he gets, a part of it will be considered to be a return of his own investment, hence tax-free. And a part will be considered to be a distribution of earnings, or employer contributions; they're indistinguishable for this purpose, hence taxable.

If you combine that with the new 401(m) tests, particularly on voluntary contributions, a lot of employers, since TRA 1986, have shied away, as a plan design matter, from voluntary employee contributions. They now involve too many headaches, both in terms of meeting the 401(m) test each year as well as tracking these monies, so you know how much of a distribution is taxable and how much is a return of tax-free dollars. And more important, make sure employees understand it. There's no point in having a benefit program and then having a lot of unhappy employees when they find out that they didn't understand that they can't really get out their money on a first-dollar basis anymore.

Now, if the plan had a provision in May 1986, which is the TRA 1986 grandfather date for this purpose, which said that you could take out your own after-tax monies first, then to the extent that a participant has a separate after-tax account consisting of monies which he put in prior to 1986, he can tap into those monies on a first-dollar basis until they're used up. So, for example, suppose the employee had contributed $2,000 of his own dollars prior to the end of 1986, and $3,000 since that time. Assuming he's never taken anything previously, he can take out up to $2,000 now, treat it as a tax-free recovery of his own investment before he goes over to the proportionality rule.

The other break that they gave was that although they could have said that once it's in a plan, you test it against all monies in the plan. I believe it was the Technical and Miscellaneous Revenue Act (TAMRA) of 1988 or one of the post-TRA 1986 acts that made it clear that if the plan tracks the employee contributions in a separate account, then it can treat that separate account as the only monies against which the proportionality has to be tested. That's helpful for the employee. If he has a separate account consisting of his own money and earnings on his own money, then any distribution is going to have a higher percentage of return of after-tax dollars, and a lower percentage of not-yet-taxed dollars, than if it had been tested against the entire plan, taking into account employer contributions, 401(k) contributions, and everything else.

Those are the rules with regard to a distribution prior to the annuity's starting date, meaning retirement, death, termination, or other trigger event. The rule at the annuity's starting date is similar, but slightly different. If the employee has now reached his retirement or termination, and is going to start drawing down his monies, and he has these after-tax contributions, then we have to get him back his investment in a manner in which he doesn't have to pay tax twice. And we do that by calculating an exclusion ratio.

The exclusion ratio compares the amount of monies that the employee has contributed during his participation against the expected return over his life expectancy using the tables. We don't care if he's sick or he's healthy; he doesn't have to take a step test, we just look it up in the annuity tables and do a calculation. So, if somebody's 65 and he's going to take this $10,000 a year distribution, and maybe he's contributed $20,000 of after-tax monies, he may have something like a 10%, 15%, or 20% exclusion ratio. Whatever it is, once it's calculated, it's applied to each monthly or quarterly or annual payment. So if we had a 20% exclusion ratio, as he gets $10,000 each year, $2,000 of it would be considered nontaxable and $8,000 taxable. After 10 years, he would have recovered his $20,000 hypothetical investment. If he continues to live past the 10 years, having recovered his full amount, every dollar after that will suddenly become taxable. If he dies before the 10 years, say after the fourth year, if there's a benefit continuation to his beneficiary, then we'll continue the exclusion ratio to the beneficiary until the $20,000 is exhausted. If there is no beneficiary continuation, or if the beneficiary also dies before the full $20,000 is used up, then any unrecovered amount will be considered a tax loss, which is deductible on the participant's or the beneficiary's final income tax return. In this way, there is a full recovery of the investment, no more, no less, and it's simply a matter of timing.

If you have a plan with after-tax contributions, and there is a qualified domestic relation order (QDRO), typically in a divorce situation, then you have to allocate these after-tax monies between the participant and the alternate payee. The code suggests that it will be allocated pro rata between the participant's interest and the alternate payee's interest. I've never seen the IRS take a position as to whether the parties can negotiate something different from a strict pro rata. Presumably, the IRS shouldn't care as long as the parties reach agreement, but I simply don't know of a case in which anybody's tested it.

Before we get to lump sum, I won't go through each of the special rules but one that I wanted to focus on because it does feed into the lump sum is the taxation of proceeds of life insurance. Now, just as not every plan has a lump-sum option, not every plan has life insurance. It's probably safe to say that most pension plans do not have life insurance. But historically, for small-employer plans, use of life insurance as a plan feature is fairly common. But to some extent, it's a matter of saving on administrative costs, because for a small employer, his consultant or insurance broker, who may be the same person, can come to him and present a fairly cost-effective package of qualified plan document, plan investment through the insurance company, and life insurance through the pension plan so that he sort of gets one-stop shopping.

Larger employers tend to think that the things ought to be parceled out, and that life insurance ought to be handled in a life insurance program, pensions in a pension program. There's no right or wrong to it. If you do have life insurance in your qualified plan, the thing to know is that, in general, under our Internal Revenue Code, the proceeds of life insurance are tax exempt, not merely tax favored. That's the best break of all.

If you have life insurance in a qualified plan, and if the participant dies, the question is, Is it a plan distribution which is taxable regardless of rate, or is it the proceeds of life insurance, which is tax exempt to the beneficiary? The answer is a little bit of each.

Under the code and regulations, the rule is that the underlying cash surrender or reserve value of the policy, in effect, the value of the policy in the qualified trust, to the extent that's distributed, even on account of death, it is considered a plan distribution. The idea being that it existed, it was a plan investment, and while death was the triggering event in terms of the timing, that amount didn't come into being because of the death of the participant. On the other hand, to the extent that the life insurance policy exceeds the value of the policy, that is considered to be the proceeds of life insurance. It only came into existence because of the death of the participant.

Let's suppose we have a participant and he's been in the plan a couple of years, he's covered for $100,000 of incidental death benefit, which is insured through a life insurance policy. And let's suppose the policy has a $20,000 value. If he dies, the insurance company will pay $100,000, $20,000 of which would be a taxable distribution from the plan. The $80,000, that is, the excess of the 100 over the 20, will be the tax-free proceeds of life insurance. That sounds fairly simple and fairly commonsensical.

The thing to note, when we talk about lump-sum distributions, is that a lump-sum distribution has to be made entirely in a single year to the recipient. Let's say you have a situation, and I've seen this happen, where an employee has a life insurance benefit in a plan, and has a side account or an additional investment account over and above the life insurance, and death occurs in November or December of a plan year, or calendar plan year, we'll suppose, and somebody notifies the insurance company and they pay that $100,000. Meanwhile, the plan administrator is waiting for the end of the year to redo his accounts before he makes the final distribution of the basic account to the beneficiary. When the insurance company paid the $100,000 in, let's say, December 1990, they included in that $100,000 the $20,000 of plan benefit. Having paid $20,000 of plan benefit in 1990, if the plan now pays the remaining amount, the noninsured amount out in 1991, they've blown lump-sum treatment because they've split the plan distribution between two years. If you want to avoid that, don't be in a rush to notify the insurance company; or if you are in a rush, be in a rush to get the plan administrator to make distribution of the non-insurance assets. Or, realize that the cost of getting the life insurance proceeds quickly is indeed changing the lump-sum tax treatment.

Loans have been a subject of a fair amount of comment the last few years. Again, like lump sums, it is not something that you have to have in a plan. It's a plan design feature, and an employer decides whether a plan will or will not have loans. Traditionally, most employers, especially if we're talking about medium- to large-sized employers as opposed to tax-shelter-type of plans, frown on loans. They were a big pain in the neck, nobody wants to be processing them and nobody wants to be collecting on them. The thing that made loans so popular, aside from the tax-shelter-type of situation, was 401(k). When 401(k) came along, everybody had to make sure that they had meaningful participation by the nonhighly compensated employee group. And most people were pleasantly surprised to find that even rank-and-file employees were conscious of the tax-effective savings aspects of 401(k), particularly if there's an employer match.

On a percentage basis, you could get meaningful participation by the nonhighly paid, as long as you could give them some assurance that in the event of an emergency,

they can tap into that money, that is, they don't always have to wait to age 59 1/2. The two ways you can do that are hardship distributions, which we'll not cover here, and loans. And therefore, an employer which would never dream of putting a loan in a traditional retirement plan will quite commonly include loans in their 401(k) plans.

Now, there are two sets of rules here, tax rules and Department of Labor rules, and you have to know both. They aren't exactly in conflict, but they don't mesh that well. And if you only know one set of rules or the other, you may come away with the wrong idea. The basic rule with regard to loans is that any loan which exceeds the applicable limitations is going to be treated as a taxable distribution. To make matters worse, if the loan is from a 401(k) plan, and you have a deemed taxable distribution under these Section 72 rules, then at least, in theory, if the participant is less than 59 1/2, you may have jeopardized the entire 401(k) plan. Does that mean, if you have a nonqualifying loan to a rank-and-file participant in the General Motors 401(k) plan, that suddenly it's disqualified as to three or 400,000 employees? I don't know if anyone is here from the IRS. Assuming they're not, the answer is probably that the IRS would not do anything quite that arbitrary. Nonetheless, they do reserve the right to do so, because under the combination of these rules and the 401(k) rules, that would be a pre-59 1/2 in-service distribution. Therefore, employers who do have loan programs have to be very careful to meet the qualifications and the limitations.

There are basically two types of limitations on loans. First is the amount. The loan amount includes the new loan, all prior loans to the extent they haven't been paid off, and all loans from other plans of the same employer or any affiliate of that employer. That is, you can't go over the limit by taking one loan from the subsidiary plan and one loan from the parent's plan. The basic limitation is that the loan cannot exceed the lesser of $50,000, which is not indexed, or 50% of the present value of the vested benefit, but not less than $10,000. Another way of saying that is under the tax rules, a plan participant could borrow up to $10,000 regardless of the amount of his vested benefit. He could borrow between $10,000 and $50,000, as long as it doesn't exceed 50% of his vested benefit, and he can never borrow more than $50,000, whether his benefit is $100,000 or $10,000,000. Fifty thousand is the cap.

The second set of rules is in regard to duration. The rule is that the loan must, by its terms, be repaid within five years. The only exception to that is for the purchase of a principal residence. When these limitations on both amount and duration first came into the law with the 1982 legislation, people said, "OK, we know we're limited to the $50,000, but why don't we just keep rolling over the $50,000 each time it comes due, and that way get around the five-year limitation." And for several years, at sessions like this, people kept asking me, "Could you wait to the end of the fifth year and then simply roll the loan over?" And I kept saying, "Well, we'll know in five years, we'll know in four years, we'll know in three years." Eventually Congress fixed it by reducing the $50,000 limitation by the amount by which you have paid down the loan, unless 12 months' prior to a second or new loan. That is, if you want to take out a $10,000 loan on June 1, 1991, and on June 1, 1990, you had a $50,000 loan which you've paid down to $40,000, it doesn't work, because the $50,000 is reduced by the $10,000 you've paid off in the last year. If you had a $30,000 loan last year, which you've paid down to $20,000, it's true that the $50,000 will be reduced by $10,000 down to $40,000. That's OK, assuming you

have enough of a vested benefit, because you only have $20,000 remaining from loan one and you have $40,000 available to you, so you can take out a fresh loan of $20,000. Does that mean, to some extent, you can continue to roll over loans as long as you do so at a level less than five years? The answer is yes. But it's at lower limits and it may not be worth the game. Now, in addition to it being repaid within five years, you have to have substantial amortization, not less frequently than quarterly.

The Department of Labor came out about a year or two ago with rules that complement the IRS rules. Under the Department of Labor rules, the availability cannot be discriminatory, it must be available to all participants on roughly even terms. There are two problems; one is the rate of interest. The Department of Labor came out with the notion that a loan is really an investment, notwithstanding that it's made to the participant, and he thinks of it as his own money. Thinking of it quite differently, as an investment, the Department of Labor concluded that if a plan is going to make a loan which is a plan investment, then it must bear a reasonable rate of interest compared to other lending institutions. A lot of people thought that was unfair and even though the Department of Labor was aware a lot of people thought this, they said tough. Therefore, most people have rules which say that they charge prime, or they charge prime plus 2%, or something of that sort. People have said that that's too high a rate, that it really ought to equate to a passbook savings loan, which can be at several points less than a prime. That makes a lot of sense, but I don't think it flies in light of the Department of Labor regulations. And therefore, somewhat reluctantly, most people have abandoned below-market rate interest on their loan programs.

Second, the loan must adequately secured. And if a participant's vested benefit is used as security not exceed 50% of the vested accrued benefit. Now, you might say, well, you couldn't borrow more than 50% anyway, so that's not a big problem. If you have a $40,000 vested benefit, you can only borrow $20,000. Fine, so you only use $20,000 of your vested benefit as your security. That adequately secures your $20,000 loan. That is true for loans above the $10,000 mark. This requirement somewhat salvaged the rule by which people with $10,000 or less, or indeed $20,000 or less, of vested benefit, could have borrowed up to the full $10,000. They can still do so, but only by posting security over and above their plan interest.

Let's turn to the rules on lump-sum distributions now. Ms. Keppler, I believe, will deal with the minimum distribution rules in her section. Lump-sum distributions, as I said before, are an attribute with regard to how we tax distributions. First thing to note is that a "lump-sum distribution" is a term of art. I think most people know this. I still get calls from people who say, "If I took all the money, that's got to be a lump sum." Well, it is in English, but it's not in the Internal Revenue Code language. The other thing to note about lump-sum distributions is if we were talking five years ago, there were three attributes: capital gains, 10-year averaging, and rollovers. Capital gains has been cut back. Ten-year averaging has been cut back, but still exists in the guise of five-year averaging. Rollover treatment of lump-sum distributions remains unimpaired, and again, Ms. Keppler will address this in more detail. Congress is pushing more and more for towards rollover treatment, and away from special tax rate treatment.

There are four elements to the definition of what a lump sum is. First is that it's from a qualified plan, in this case either a 401(a) or a 403(a) annuity plan. There are two things to note about that. One is that an IRA, which usually sounds and smells like a qualified plan, is not a qualified plan – not even a rollover IRA, which was created solely by a rollover from another qualified plan. So if you ever have a rollover IRA, you have ordinary income tax unless you roll it into something else. It is never a lump-sum distribution, therefore, it can never qualify for averaging or capital gain. The second point is, the IRS takes the position, in a lot of cases, that you look at the qualified status on the date of distribution. If you've been in a plan for 29 years, during which it was qualified, and in the 30th year you take your lump-sum distribution, and the plan is disqualified, according to the IRS you do not have a lump-sum distribution to any extent. Now, taxpayers have argued that 29/30ths or something like that ought to be a qualified lump-sum distribution. You were in the plan most of your career when it was qualified. There are enough cases in which taxpayers prevailed that the issue is still somewhat open, but the IRS has been successful in three circuit decisions, and certainly the IRS has won more than it's lost on this issue. It is not an issue on which the IRS will compromise.

The second aspect of the lump-sum distribution is that it consists of the entire balance to the credit of the participant. That sounds pretty straightforward; it's whatever is in your plan at the time of the triggering event. If you retire and you have to take it all at that time. If you retire and you want to take 10-year installments, but then you change your mind in the third year and you want the balance of the installments, it's no good. You may be taking everything that's left, but it is not a lump-sum distribution because it's not all you had at the time of the triggering event. The exception to that is for death. If you had died in the third year and your beneficiary wanted to take everything else, that's a lump-sum distribution for your beneficiary. It must be made within one taxable year of the participant. That's kind of straightforward. You look at the year of the participant, or the recipient, in the case of a death distribution, not the fiscal year of the plan, if it's on an off year. Distributions can be made on more than one date, as long as it's within the same year.

And then there are the triggers of which there are four triggers. First is death – that one's kind of straightforward. Occasionally we've had missing persons, but in most cases, you know whether it's a death distribution or not. Second is after age 59 1/2. Third is because of separation of service by a common-law employee, and fourth is disability of a self-employed individual.

Because a lot of you may be working with frozen plans for the moment, one other exception to the requirement that the distribution be the entire balance to the credit of the participant is that if there's an additional distribution which is made on account of the employee's last year of work, or any subsequent year, it does not destroy or ruin a lump-sum distribution. So, if you leave your employer on June 1, 1991, and you get a distribution next month in July consisting of everything that's currently to your credit, that is a 1991 lump-sum distribution. If it should happen that, because of your five months of work in 1991, you're entitled to a partial contribution which doesn't go in until late 1991 so you don't get the money out until some time in 1992, that 1992 distribution doesn't spoil your 1991 lump sum. It, however, will not itself be a lump sum, it will be ordinary income in 1992. That principal applies to frozen plans.

If you have a plan which was frozen for TRA 1986, in which people have a December 31, 1988, year-end frozen account balance or frozen defined benefit amount, and you haven't yet unfrozen your plan for either everybody or for highly paid because you're waiting for full compliance, somebody may have left in the intervening three years. If they got everything they were entitled to at that time, in the plan's frozen state, that's a lump-sum distribution. When you unfreeze, or defrost the plan, and you make contributions or give them additional accruals, such as sending them another check in 1991, 1992 or 1993, that will not be a lump-sum distribution, but it will not taint their earlier lump-sum distribution, assuming they otherwise qualify.

The final point is the separation-from-service concept. The separation-from-service concept is the one concept which gives a lot of people a lot of problems. It sounds like termination of employment. It sounds like that to everybody but a tax lawyer, or at least everybody but the Internal Revenue Service. In the Internal Revenue Service's view, there is a distinction between termination of employment and separation from service, under what has become known as the same-desk rule. Under the same-desk rule, you might be working for an employer, and find there is some reshuffling of the corporate structure, or the employer's structure, as for example, a partnership incorporates, or a subsidiary is sold to a third party, or a division is sold to a third party. An example would be if you went home on Friday working for ABC Company, and you come back on Monday working for XYZ Company, but you're doing the same job at the same desk next to the same workers.

For Section 402 lump-sum distribution purposes, the IRS takes the position that it is not a separation from service. Therefore, if you're not 59 1/2, and if the plan makes a full distribution to you, Abbey will tell you that you can roll it over under a separate rule, but it is not a lump-sum distribution, and therefore does not enjoy all the attributes of lump-sum distributions. For awhile, the IRS confused matters because it suggested in a 1986 General Council Memorandum (GCM) that the separation, the same desk rule which had grown up under Section 402, applicable to lump-sum distributions, might somehow, for the first time, be applied to Section 401 in terms of whether you could make a distribution from a plan to somebody whose company was sold to somebody else over the weekend. The notion here is that under a qualified pension plan or a 401(k) plan – 401(k) plans have their own rules – but under a qualified pension plan, you cannot have a distribution to somebody prior to his or her termination from employment or reaching retirement age. If the IRS had applied that same-desk rule to Section 401, then a plan would have been disqualified had it made distributions to participants because their line of business was sold. A lot of people screamed and yelled that it made no sense to force old employers to hold these monies forever. At least for the time being, it does not apply to Section 401 qualification issues. With that, I think I'll turn it over to Ms. Keppler.

MS. ABBEY L. KEPPLER: Now that Mr. Wintner has explained how your plan distributions will be taxed, I'd like to begin by discussing two ways that you may be able to defer immediate taxation, rollovers and plan-to-plan transfers.

Generally, you may roll over your distribution from one qualified plan to another qualified plan, to an IRA, to a 403(a) annuity plan, within 60 days of your receipt of the distribution. If the plan distribution is rolled over, you will not be taxed on the

distribution in the year that it's distributed and rolled over, but rather, in the year that it's eventually distributed from the rolled over plan or rollover IRA.

There are four kinds of distributions which are eligible for tax-free rollover: (1) a lump-sum distribution, (2) a distribution on account of plan termination, (3) a distribution of accumulated deductible employee contributions, and (4) some partial distributions. In order to be eligible for rollover, a partial distribution must be payable as a result of the employee's death or separation from service, or disability; it must consist of at least 50% of the employee's interest in the distributing plan; and it must not be one of a series of periodic payments. A partial distribution can not be rolled over to another qualified plan. It can only be rolled over to an IRA. In addition, if a partial distribution from a qualified plan is rolled over, subsequent distributions from the plan will not be eligible for five- or ten-year averaging treatment or special rules regarding net unrealized appreciation of employer securities.

In determining whether a distribution is a lump sum which qualifies for tax-free rollover, the lump-sum rules Mr. Wintner just discussed generally apply. However, in this case, you don't have to make a special lump-sum election, and you don't need a minimum of years of participation in the distributing plan. If the balance of an employee's account is distributed to him because of the termination of the plan, he will not have received a technical lump-sum distribution, which would be eligible for averaging or capital gains treatment, unless he was over 59 1/2 at the time of the distribution. The distribution would, however, still be eligible for rollover to a qualified plan, a 403(a) annuity plan, or an IRA if the recipient receives the distribution within one taxable year.

The question I'm asked most often, with regard to rollovers, is whether an individual can rollover a distribution to a rollover IRA after he is 70 1/2. Unlike a contributory IRA, which cannot be established after age 70 1/2, and which you cannot make additional contributions to after age 70 1/2, a rollover IRA can be established at any age. However, even if you can have a rollover IRA after age 70 1/2, you cannot roll over any amount which is required to be distributed under the minimum distribution rules. We're going to get to the minimum distribution rules in a few minutes. But for right now, if a minimum distribution is inadvertently rolled over into an IRA, it's going to be taxed in the year it's distributed from the plan, regardless of the fact that it was rolled over. It could be subject to an additional 6% tax if it's not withdrawn from the IRA by the time of the filing of the individual's tax return. And, when it is eventually distributed from the IRA, it'll be taxed again. So, it's clearly a situation that you want to avoid. If you have property distributed from a plan in kind, it also can be rolled over. It can be rolled over either by rolling over the property itself or by selling the property and rolling over the proceeds. However, you can only roll over the property or the proceeds of a sale. You cannot decide to retain the property and roll over an amount which is equal to the value of the property.

Rollovers are extremely popular because they allow for a great deal of flexibility. An eligible distribution can be rolled over to more than one IRA. This gives an advantage in case you don't want to put the entire distribution with one investment manager, or all into one mutual fund. You can split it; you can have a rollover IRA at a brokerage house, rollover IRAs with mutual funds, rollover IRAs at banks investing in CDs. In addition, you can roll over a portion of the distribution. However, the amount that's

not rolled over will be subject to ordinary income tax in that year, and will not be eligible for averaging or capital gains treatment.

The second method of deferring taxation is to not receive the distribution at all, but instead to elect to have your benefit transferred from one plan to another plan in a direct plan-to-plan transfer. The authority for plan-to-plan transfers isn't really found directly in the code, but has been established through a series of revenue rulings and private letter rulings. Plan-to-plan transfers are often used as an alternative to distributions and rollovers in the context of corporate reorganizations. There are certain advantages that you can obtain through a plan-to-plan transfer that can't be achieved through a rollover. One is the tacking of years of participation that can be used in determining whether a subsequent distribution from the transferee plan is eligible for averaging treatment. In addition, loans and nondeductible employee contributions cannot be rolled over. However, loans and nondeductible employee contributions can be transferred in plan-to-plan transfers. Direct transfers can also be made from one IRA to another. Since the transfer is not considered to be a distribution, it can be done several times during a year, whereas you're limited to one IRA rollover per year -- a rollover from one IRA to another. And that's because you have a 60-day period with a rollover in which the funds are in your hands and you'll have use of them. So the IRS has limited IRA-to-IRA rollovers to once per year so that you do not have continued use of the money. Plan-to-plan transfers never go through your hands, so in that case you can have as many as you want per year.

Leaving the methods of deferring taxation for a moment, we'll return to the subject of paying taxes. Generally, distributions from qualified plans, annuity plans, and IRAs will be subject to ordinary income tax in the year or receipt, or may even be afforded favorable averaging treatment, resulting in lower taxes, as Mr. Wintner discussed earlier. However, there are a series of excise taxes that you should be aware of which will apply in a variety of situations. The excise taxes apply to distributions which are too early, too late, too little, too much, or much too much. Individuals who don't pay attention to these various additional taxes could end up paying more than would otherwise be required with some planning.

The first of these excise taxes is the uniform additional 10% tax that's imposed on premature distributions -- the too-early tax. The basic rule is simple. An additional 10% tax is imposed if the recipient is younger than 59 1/2 when the money comes out of the plan or the IRA. There are several exceptions to the rule. The first exception is for amounts which are rolled over, although this is not technically an exception to the rule. These amounts are not subject to tax because they're not includable in income in the year that they're rolled. The second exception is for distributions made on account of death or disability. The third exception applies to distributions in the form of an annuity or substantially equal period payments payable over a life expectancy, or a joint life expectancy.

There's an IRS notice that lays out the acceptable methods of computing these payments, in order to assure that the payments fall within the exception, and are not instead tailored to an individual's cash needs on an annual basis. In order to ensure that this particular exception was not abused, the IRS has provided for a recapture of the 10% tax if there's an acceleration in the payments before the latter of attainment of age 59 1/2 or five years of the date of the initial distribution. The 10% additional

tax is payable in the year of the acceleration, along with interest for the deferral period. The way the interest works is it is calculated as if the 10% tax had been due in the year of the distribution, but as if it was not paid until the year of the acceleration.

The fourth and fifth exceptions apply to distributions from qualified plans, but not IRAs. The fourth exception is for distributions received after age 55, after separation from service, sort of an early retirement exception. The fifth exception applies to distributions used for payment of deductible medical expenses which would in fact be deductible on the individual's tax return if he itemized his deductions in that year. For example, if there's a person with adjusted gross income of $100,000, he takes a hardship withdrawal from a plan in the amount of $13,000 to pay medical expenses. The first $7,500 of the distribution will be subject to the 10% additional tax, because it is not in fact a deductible medical expense because it does not exceed 7.5% of adjusted gross income. The remaining $5,500 would not be subject to the tax because it would be a deductible medical expense. The individual does not, in fact, have to itemize on his return in order to take advantage of the exception. Finally, corrective distributions of excess deferrals and excess voluntary contributions, which are required by law, are excepted from the additional tax. If none of the exceptions apply, the additional 10% tax will be imposed on all distributions received before age 59 1/2.

The next excise tax to consider is the one referred to as too late and/or too little, otherwise known as the tax which results from the failure to receive a minimum distribution. This tax applies to failures to receive minimum distributions from Section 457 plans, Section 401(a) plans, Section 403(a) annuities, Section 403(b) tax-sheltered annuities, and IRAs, and is equal to 50% of the difference between the amount which would be required to be distributed under the minimum distribution rules, and the amount actually distributed in that year.

In order to determine whether you owe a tax on a failure to receive a minimum distribution, you have to understand how the minimum distribution rules work. The minimum distribution rules require that distributions commence by the April 1 that follows the calendar year in which you attain age 70 1/2. Prior to the 1986 act, the required beginning date was the latter of attainment of 70 1/2 and actual retirement, unless the recipient was a 5% owner. Individuals who turned 70 1/2 before January 1, 1988 are grandfathered under the old rule, and are not required to take their distributions until they retire. The amount required to be distributed under the minimum distribution rules is generally determined based on life expectancy or joint life expectancy. And for this purpose, life expectancy is determined according to the tables under Section 72 of the regulations. Life expectancy of the participant and the participant's spouse, if the spouse is the beneficiary, may be recalculated annually. However, if the beneficiary is anyone other than the spouse, the life expectancy cannot be recalculated. Obviously, you will lengthen the life expectancy if you recalculate it.

The initial calculation of the amount of the minimum distribution is determined at age 70 1/2, and then minimum distributions are calculated annually on a plan-by-plan basis. If the plan benefit is being paid in the form of life annuity or a joint-and-survivor annuity where the spouse is the beneficiary, the annuity will, by definition, comply

with the minimum distribution rules. Other forms of annuities will actually have to be tested.

In the case of an individual account plan or an IRA, you determine the minimum distribution each year by taking the balance as of the end of the preceding year, adjust that for any contributions, distributions, or forfeitures made after the end of the year, with respect to that year, and divide the balance by the applicable divisor from the life expectancy tables in the Section 72 regulations. For example, if an individual attains age 70 1/2 in 1990, he must receive a minimum distribution for 1990 by April 1, 1991. If his account balance as of December 31, 1989 was $200,000, and the joint life expectancy of the individual and his spouse is 20 years, his minimum distribution for 1990 would be $10,000. If the individual only received a distribution of $5,000, he would be required to pay an additional tax of $2,500, 50% of the difference between what he was required to receive and the amount he actually received. After the first distribution year, you no longer have that extended period until April 1, and the distribution must be made by December 31 of the distribution year.

It may have occurred to you that the minimum distribution rules could be substantially avoided by the selection of a very young beneficiary, say, perhaps, a grandchild. Congress anticipated this tactic and provided, along with the minimum distribution rules, an incidental death benefit rule. Basically, the incidental death benefit rule provides a table of maximum divisors by age. If, when you look up the joint life expectancy of the participant and the beneficiary, it exceeds this applicable divisor, you're limited to the use of the applicable divisor. This is true in all cases except where the beneficiary is the spouse. The incidental death benefit rule will not apply if the beneficiary is the spouse, and the actual joint life expectancy can be used regardless of the difference in the ages. In order for a plan to be qualified, the plan must incorporate the 401(a)(9) minimum distribution rules. In addition, although proposed regulations indicate that a single failure to make a minimum distribution would not result in plan disqualification, a routine disregard of these rules could cause the plan to be disqualified. In addition, the tax could be waived if the taxpayer establishes that it was due to reasonable error.

In addition to the minimum distribution rules that we just discussed, which basically apply to lifetime distributions, there's a separate set of minimum distribution rules that apply to the payment of death benefits. The rules that I've been discussing are the legal minimum distribution rules, which provide the latest date that you can commence your distributions and the most liberal means of calculating the minimum amount to be distributed each year. However, in the case of a qualified plan, the actual plan provisions will prescribe the forms of payment that are available under the plan. Although the payment options cannot violate the minimum distribution rules in operation, a plan is not required to provide the maximum degree of flexibility allowed under the law. For example, you could have a profit-sharing plan that allows only lump-sum distributions or 10-year installment payments. Or you could have a pension plan that doesn't allow you to recalculate life expectancy. In these situations, you might consider taking a lump-sum distribution from the plan and rolling it over into an IRA. Because, in an IRA, you can control the forms of the distribution and you're limited only to the legal limitations of the 401(a)(9) regulations.

The next excise tax is the additional tax applicable to retirement distributions which are considered to be too much in one taxable year. This tax, unlike any other excise tax, will apply even if you have not done anything wrong in accumulating your retirement savings. You have simply played the game too well. It is, in a sense, a recapture tax that's applicable to the distributee and not the employer. The excise tax on excess distributions was added by the Tax Reform Act of 1986, and imposes a 15% additional tax on individuals who receive excess distributions in a taxable year. In order to determine whether you have received an excess distribution, you have to add the distributions you received in one year from qualified 401(a) plans, 403(a) annuity plans, tax-sheltered annuities, and IRAs, and then compare the sum to an annual limitation.

In calculating, or in aggregating these amounts, there are certain sums which can be disregarded. The first are distributions made on account of death, and you'll see later why those can be disregarded. Also, distributions to an alternate payee can be disregarded, but that is because they'll be included in the alternate payee's calculation to determine whether he or she has received an excess distribution in that year. Another situation is a return of an employee's nondeductible contributions, theoretically because you didn't get a tax break when you contributed those amounts to the plan. Also, in distributions which are rolled over, theoretically, again, these distributions will be included in the year that they're eventually distributed from the plan or IRA they've been rolled into. The value of a distributed annuity contract to the extent not includable in income, corrective distributions of elective deferrals or voluntary contributions, and distributions of medical benefits from Section 401(h) accounts are also disregarded. There are, however, some amounts which are included in the calculation even though they're not includable in taxable income for the year, such as net unrealized appreciation on employer's securities. Generally, an individual will receive an excess distribution to the extent that the sum of the considered distributions exceeds the greater of $150,000 or an annual indexed amount, which is now $136,204. Since the indexed amount is adjusted annually, it will soon overtake the $150,000 limitation.

Lump-sum distributions for which the individual has elected averaging treatment are subject to a separate limitation, equal to five times the annual limitation. This means, for 1991, the greater of $750,000, or $681,020. You might wonder why there are alternative limitations. And actually, the alternative limitations have little significance, except with respect to certain individuals who elected a grandfather rule that was included as part of the 1986 act along with this excise tax. The grandfather rule was available to individuals who had accrued benefits that exceeded $562,500 as of August 1, 1986, and elected the grandfather rule on a 1987 or 1988 tax return. If the grandfather rule was elected at that time, the individual is required to use the annual indexed amount in determining whether he has received an excess distribution in a year. He's not allowed to use the higher limitation, the $150,000 or $750,000 limitation. And that's the only continuing significance of having alternate limits.

An individual is permitted to receive both a maximum annual distribution and a maximum lump-sum distribution in a single year. That means for 1991, if you are receiving a lump-sum distribution and an annual distribution, you could receive up to $900,000 without having the excise tax apply. This presents an opportunity for some tax planning. It might indicate that you should roll over a distribution to an IRA

rather than a qualified plan, so eventually, when you take the distribution from the qualified plan, you can take that as a lump-sum distribution while taking an annual distribution from the IRA. In this way you can minimize the amount that is subject to this excise tax on excess distribution.

Now, assume that you've managed to defer receipt of your distributions until after age 59 1/2, and have timely commenced distributions before age 70 1/2. You've been careful to make sure that you distribute at least the amount required by the minimum distribution rules, but not so much as to exceed the limitations of the excess distribution rules. And you've been lucky, because you haven't been put into the position where the amount required to be distributed under the minimum distribution rules ever exceeded the amount that you were entitled to take out under the excess distribution rules without the payment of an excise tax. In short, by careful planning, you've managed to pay only ordinary income tax on your distribution, and you're well into your retirement.

At this point you might breathe a sigh of relief and think that you've won the game. But not so fast. The IRS has one additional trick up its sleeve, the excise tax on excess retirement accumulations, the tax on much too much. This is an additional estate tax equal to 15% of the individual's excess retirement accumulations. It's sort of a companion tax to the 15% excise tax on excess retirement distributions. In order to determine whether there is an excess retirement accumulation on death, the value of the aggregate of the individual's remaining interest, in qualified plans, 403(a) annuities, tax-sheltered annuities, and IRAs are compared to the present value of a single life annuity with annual payments equal to the annual limitation used to determine excess distributions in the year that the individual died, which is now payable for a period equal to the individual's life expectancy determined immediately prior to his death. To the extent that the actual value exceeds the amount of this hypothetical annuity, the accumulations are considered to be excess, and will be subject to the additional 15% estate tax. Of course, in order to minimize this tax, you might consider proper eating habits, giving up smoking, adopting a regular routine of exercise, thinking that the longer you live and are able to take distributions during your lifetime, the smaller the amount that will be left on your death and the less likely you'll have the tax on excess retirement accumulations. However, this is not always the case. Because if the principal amount of your retirement savings is high enough, say perhaps $1.6 million, and you're earning 10% a year, then if you only take out as much as you can without incurring the excise tax on excess distributions, you'd be taking out $150,000 a year and earning $160,000 a year, and the principal will simply grow each year.

There's one exception to the automatic imposition of the excise tax on excess retirement accumulations, and that applies if the retirement accumulations are payable to the surviving spouse. The surviving spouse can then elect not to have the excise tax apply on the individual's death, but rather to apply at her own death, as if those interests were her own. If the spouse does not make the election, the additional 15% tax will apply even though these interests are not subject to regular estate taxes as a result of the unlimited marital deduction.

Prior to the addition of the 15% excise tax on excess retirement distributions and excess retirement accumulations, tax planning, with respect to retirement distributions,

was fairly easy. You simply followed the well-accepted principles of maximizing contributions, deferring and minimizing distributions for as long as financially possible in order to take advantage of tax deductions and the benefit of tax-deferred compounding of earnings. The only question was, Were tax rates going to go up or down in the interim? Now, however, you also have to consider whether these advantages will be eroded by the 15% excise tax on excess retirement distributions and accumulations. Although it's impossible to predict the eventual value of the retirement accumulation, it's worth the effort to attempt some projections. Sometimes the problem is extremely evident, such as the case of an individual who might have worked for two extremely generous employers, and accrued $100,000 annual benefit under each employer's plan. In other cases, especially those involving defined contribution plans and IRAs, a more sophisticated analysis based on a variety of assumptions could be required to detect the problem. If an analysis of your retirement benefits indicates that you may have an excess problem, you might consider commencing distributions earlier than the required beginning date, or opting to receive more than minimum distributions in a year. Also, you could consider negotiating nonqualified benefits from an employer, instead of qualified benefits, or, choosing lump-sum distributions and averaging treatment, or IRA rollovers. In any event, the earlier you undertake an analysis of the potential excise taxes that could apply to your retirement savings, the more likely it is that you can take some action to minimize these taxes and increase the after-tax proceeds.

MS. GRANT: Thank you both for the extremely thorough presentation of the issues here. Does anybody have any questions?

FROM THE FLOOR: Number one, in a secular trust, do you, considering the tax of the income of such a trust, consider the income in a secular trust taxable to the employer as well as to a vested employee? Is the income of a secular trust taxable to the employer as well as to the employee?

MR. WINTNER: My understanding is it would be taxable to the employee only, and not to the employer, at least to the extent it's fully vested, which I think was your caveat.

FROM THE FLOOR: That is correct.

MR. WINTNER: For income tax purposes, effectively, it's the employee's property, notwithstanding that the trust itself might say it's not distributable until some future event. Having been segregated in a trust and become vested, the earnings of the secular trust, after that, should be taxable to the employee. And that is why, by the way, I know TPF&C knows this better than I do, most secular trusts, although not all, probably have a provision which would allow distribution by the trustee of the amount necessary for the employee to pay his current tax bill. That's a plan design issue, it's not a necessity, but it makes sense.

FROM THE FLOOR: If it's a nonqualified pension plan being funded through a secular trust, then the employee is solely taxed on it. But in other situations, it's not so clear. So that's why I was asking the question.

MS. GRANT: You alluded to some good financial planning opportunities and under these tax laws the results of not planning astutely could be pretty expensive. To what extent do you think that employers can give advice, financial advice, on how to treat the tax rules and what are the best options, what are the limitations on employers, and going beyond that, what are the responsibilities of employers for not giving that kind of advice?

MR. WINTNER: Well, the legal minimum is that employers have to give a lump-sum notice.

MR. WINTNER: At a minimum, there is a requirement under the law with regard to lump-sum distributions. An employer must provide a statutorily required description of lump-sum distributions. It's a one- or two-page model which the IRS came out with some years ago. You'd have to modify it for changes in the law, but it basically tells you what your roll over rights are and alludes to capital gain or averaging to the extent they still apply. That is, indeed, a bare-bones requirement. You should pay attention to it, because a failure to make that distribution carries with it a penalty tax for the plan administrator.

I think your question is, to the extent the rules go over and above the IRS model, does an employer either have a legal or a nonlegal duty to inform his employees? The problem is that the law does not like volunteers. The law does not punish an employer who says nothing. But the law may very well punish an employer who gives advice which is either misleading, misinformed, or may be misconstrued by an employee. Therefore employers, typically in the past, have been a little gun-shy about giving too much advice and have hidden behind the old rubric of telling employees to go get their own tax consultant, recognizing that when you're talking about a rank-and-file, you know he's not going to do it. There's no real satisfactory theoretical answer, and the realistic answer is somewhere in between. Bear in mind, though, that for most of the more exotic types of issues that we deal with here, and a lot of these excise tax issues really are for your high-paid employees. They at least will be the people who can afford their own tax advisor, whether it happens to be the employer's own experts or their own personal experts. Nonetheless, having dodged the question, basically, we tend to be cautious somewhere in the middle. And if there is a spinoff of a plan, or a sale of a division and the resulting distributions, we tend to give the minimum advice, not the maximum advice, just because it is so easy to be misconstrued. You have 100 or 1,000 people who may come back to you or your client and complain later about the advice.

MS. GRANT: I'm not talking about an ethical responsibility. Do you think there is a legal responsibility to, at a minimum, suggest that individuals get financial planning advice? Is the employer at any risk? I think I heard you say no, there's not a risk in not giving direction.

MR. WINTNER: I think there is no legal risk in not giving any direction over and above the minimum lump-sum distribution notice requirement. The only modification is if you have a 401(k) plan, to some extent, you have to give a little bit of tax advice in the summary plan description, just to make sense of why people should have a 401(k) plan. But that aside, we tend to give less advice rather than more advice. And again, I do want to emphasize, with all the complications that we talk about for

most employees none of these will be issues. They are tough issues, but they only hit a handful of people.

MR. WILLIAM W. KEFFER: I'd just like to confirm my understanding of your comments on nonqualified distributions. As I understood it, if there were a fund with an employer, say a deferred compensation fund, it would be very difficult to get that money from the employer's hands into an individual's hands in total without some tax consequences on the total. You can't roll it over to an IRA, you can't do anything with it, basically, except allow the employer to distribute it in some manner, say by purchasing an annuity. The individual cannot purchase an annuity – have I got that straight?

MR. WINTNER: I think so. I think you viewed it from about six different sides, but the basic problem is, in a nonqualified arrangement, either the employee is going to be fully taxed, but he's going to be secure that he has the money, or, if he doesn't want to be fully taxed up front, up front meaning at retirement, not at the beginning of the period of deferral, then he is going to have to remain subject to the risk of the business. And in fact, he's just another creditor of the employer. Therefore, we see a lot of arrangements where people say, "When I reach 65, go buy me an annuity." Well, that's OK, the employer can buy the annuity, and if the employer remains the owner of the annuity policy, what it means is the employee has a fair assurance that the employer will have the liquidity, that is, he'll have the cash with which to make the annual payments, because it's coming from the insurance company. But if he retires at 65 and in five years the company goes under, the ownership rights in that annuity policy are just another asset of the employer. And if that's the point at which the employer goes under, the retired employee is at risk. If he wanted to not bear the risk, he had to take the money as income. Now, secular trusts and rabbi trusts and other arrangements which go beyond this discussion are halfway measures. And to some extent, either they give the employee the comfort of liquidity, or they give him psychic comfort but not legal comfort. A lot of them do just that, because the employee thinks he has some more protection against the creditors, but if a rabbi trust has been crafted properly, that's not the case.

Or, it segregates it and what the employee really thinks he's going to do is know when to pull the plug. He doesn't wait until the employer is dead in the water; when the employer starts to look weak, then he has a reserved right, perhaps, or he'll go and renegotiate and say, "OK, even though I'm only 68 and I have another 12 years of expectancy coming, I don't think you're going to make it for 12 years, so why don't we cash out the arrangement now." And at least the employer has the ability to raise the cash then because he has the annuity. The problem is if the employer's in that kind of straights at that point, the treasurer, unless he's the best friend of this retired executive, may say, "Oh, I forgot about that money. You know, we could use that to improve something, why would we give it to you now? We need that money."