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The Tax Man Cometh—Making the Most of Planning Opportunities After Pension Simplification

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Summary: Recent changes in the tax law have introduced new dynamics relating to individual tax planning opportunities. This session examines tax strategies for distributions from qualified plans, including:
- *suspension of excise tax on large distributions,*
- *elimination of Internal Revenue Code Section 415(e) combined limits,*
- and *elimination of five-year averaging on lump-sum distributions.*

Mr. William W. Bush, III: Elliot Dinkin has an MBA in finance and accounting from the University of Pittsburgh. He worked for Price Waterhouse for 13 years and now runs his own firm in Pittsburgh. I'm an FSA, and I work for William M. Mercer in Pittsburgh. We're going to be talking about how some of the tax laws have changed, and how they might affect you.

Mr. Elliot N. Dinkin: I recently met with an associate and a client, and a point of discussion on our agenda was changing the valuation method for funding purposes from an actuarial evaluation to a market value. As you know, the actuarial value has more of a smoothing out, and the fair market value is much more immediate. As of December 31, 1996 there was about a $15 million difference in the different values. My argument was maybe we should look at changing the method so that over the next couple of years we would save a little bit of money as far as funding. We went through all the exercises and walked out of the room, but as I was leaving, the Chief Financial Officer (CFO) called me back into his office. He had his computer on and said he wanted to show me something. At that point the market

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had dropped 550 points. He asked what this would do to my analysis. I said, "Well, the spread is probably not quite $15 million; as of today it's probably closer to $5 million." So when you're looking at changing assumptions, the lesson is you never know what will happen.

When I was asked to make a presentation at this meeting about different changes in the tax law, I was thinking about different topics to review, and one of my concerns was looking at making sure the topics were relevant in light of all the changes and benefits in consulting today. Obviously, things are much different today than they were when I started. There are lot of different pressures on companies as far as mergers, downsizing, and outsourcing. There is a lot of consolidation in the marketplace on service providers, and there is a lot of concern about telecommuting. There is a whole new environment of employees, especially out west, who want to stay at home and do work and commute via the computer. There is a lot of pressure on companies to provide flextime. When I started out at Price Waterhouse, the concept of flextime was when you told your superior you needed to have more time off to be with your family, and he or she would tell you that's what Sundays were for. This is the way things are, and because of that, we need to look differently at the way we model our benefits.

I recently met with a new client to look at incentive compensation and retirement plan options. He's in the retail business and has a chain of bookstores and a chain of some fast-food restaurants. He informed me that his average turnover was 45 days. His average training time for his employees was less than two hours. He showed me what the cash register board looked like. There was a picture of all the food items on the cash register. If somebody ordered a hamburger with cheese, the cashiers just had to push the button with the picture of a hamburger and cheese and enter how much money the customer gave them. The cashiers had to smile occasionally and that was it. His challenge to me was to design some kind of retirement plan, keeping all that in mind. He said he had some key employees who were managers who stay for longer than 45 days.

Some of the items that we're going to talk about are intended to reflect first, some of the tax law changes, and second, some of the different trends. Let's discuss some changes in the new tax law. The changes we're going to talk about are recently enacted provisions of the Taxpayer Relief Act of 1997. This is the second year in a row that there have been some significant changes in tax laws that affect pensions of benefits. The year before that we had the Small Business Job Protection Act. There are some other bills pending in Congress that will probably pass in 1998. We might see three successive law changes.

The Taxpayer Relief Act also had a lot of changes dealing with Medicare. We're not going to talk about those. We're just going to talk about the tax issues. Probably the most notable change of the Taxpayer Relief Act was the largest tax cut in 16 years, including lowering the capital gains tax rates and a lot of changes dealing with estate planning. We're going to go through some of these. If you have any questions or comments along the way, don't feel bad about interrupting.

The first item is dealing with cash-out of accrued benefits. Under the current law, I don't have to have the employee's consent if the lump-sum value of my benefit does not exceed $3,500. Effective for plans beginning after August 5, 1997 (for most companies that would be 1998), that level has increased from $3,500 to $5,000. There is no amount included in the law to adjust for inflation, so if this is ever increased again, it would have to be done through a legislative act. Basically, what this means for a lot of plans is that individuals who work for my client in the fast-food industry didn't accumulate a lot of money in the benefit plans. It gives the company the opportunity to cash them out earlier than before. It may help them from an administrative standpoint and it might give them some relief from the PBGC premium standpoint, etc., so that is a slight change.

The next item is the repeal of the excess distribution tax. Back in 1986 there was a series of excise taxes passed. They were labeled "too much too soon," "too little too late," "too much too late." The too much too soon was the 10% premature distribution tax on withdrawals from a qualified plan before age 59 1/2. We're going to talk about some of the exceptions in some detail. Too little too late dealt with the 50% excise tax on failure to take a required minimum distribution at age 70 1/2. If you didn't take them and took too little, you were subject to an excise tax of 50%, which was calculated as the difference between what you should have taken versus what you did take. That difference was subject to a 50% excise tax. The one that caused the most concern was the 15% excise tax on excess accumulations. Basically, if we prove there is more than $150,000 from a qualified plan, it could be subject to a 15% excise tax.

There was also this excise tax that was imposed on an estate. It looked at what the future value and the stream of payments were the day before you died. If they were more than $150,000, the estate was saddled with a 15% excise tax. In the original law it didn't matter whether or not you had a rollover to a spouse; it applied anyway. That part of the bill was changed around 1990.

The Small Business Job Protection Act also made one change to this provision and gave a high interest period for three years. It said we want to impose the tax for three years. All that is now off the slates. Effective in 1998, the 15% excise tax is

eliminated in its entirety for any distributions after 1997. We scurried around for a long period of time analyzing all the qualified plan rules to try to avoid this 15% excise tax. We did many studies of grandfathered elections. What we found out was that once the law was changed, most people were just able to defer the money. The government decided that this might not be such a good idea because it was not getting enough revenues in the door by encouraging people to defer distributions from qualified plans. That's when it came out with the Small Business Job Protection Act and put this little window of opportunity in. It realized that if it was going to eliminate the three years, it might as well eliminate it in its entirety.

There is still some planning that has to be done. For example, I have to make sure I still comply with the age 70 1/2 distribution requirement. What's more important is that it tends to make us focus on an item that we forgot about from an individual standpoint and from a client standpoint: Do people have enough aid to live on? People have accumulated a lot of wealth. Are they investing it properly? You always hear these horror stories about an individual who had $1 million at age 65 and he or she lived to be 90 and ran out of money because he or she invested in CDs at age 65 because he or she didn't want to take any risks. They weren't investing for the long haul. I think the lesson is that maybe we should go back and look very closely at our clients or individual plans from a different perspective as well as make sure that their estate and investment plans are up to snuff. When I was first asked to speak, that was going to be half the topic. When the law got changed in August, it changed the thought pattern a bit. There was some maneuvering you could do, but now the excise tax is gone. There's really not much to worry about in that regard.

There is a modification on the 10% tax on nondeductible contributions. There is an excise tax imposed on nondeductible contributions to qualified plans. There is another exception under the rule. If I sponsor both a defined-benefit (DB) plan and a 401(k) plan, the law says that the amount of the contributions to the 401(k) plan that does not exceed the amount of the employer's matching contribution, plus the elective deferrals to the 401(k) plans, are not subject to the excise tax.

From the Floor: If we have a situation where the 401(k) and match plus the DB contributions exceed 25%, does the portion of the 401(k) and match that exceed the 25% become deductible in the future year under a carryforward?

Mr. Dinkin: I guess it would. I don't think the law changes that aspect of it. This just deals with the excise tax and doesn't impose the excise tax requirement.

The next item is dealing with plans accepting rollover contributions. There were many problems for many plans that wouldn't accept rollover contributions without getting a determination letter from the plan that was making the distribution on the grounds that they were worried about their assets being tainted. This is more of an administrative relief. It's not necessary for a distribution plan to have a determination letter in order for the plan administrator of the receiving plan to reasonably conclude that the contribution is a valid rollover. This sort of takes some of the pressure off the receiving plan and tries to make this a little more attractive for companies to accept rollovers. This responds to what the government perceives as events and occurrences out in the private sector.

Let's discuss changes in dealing with summary plan descriptions (SPDs) and summary of material modifications (SMMs). Effective August 5, 1997, employers no longer have to file SPDs or SMMs with the Department of Labor (DOL). It does not relieve me of the requirement of furnishing those documents to my employees. It just means that when I do that I don't have to send a copy to the DOL. Personally, I never knew what they did with all those documents anyway. I guess they thought the same thing. Again, it doesn't relinquish you from the requirement of giving them to your employees. Many people think that they're off the hook on this aspect of it, but that is not true. In fact, if and when you get a notice from the DOL saying that you have to give them a copy of the SMM or SPD and you don't provide it, you could be subject to a $100 per day penalty and a $1,000 per request charge for the failure to comply with such a request. If an employee files a complaint against you, and the DOL assigns a case officer to the item, he or she can ask you to furnish an SPD and SMM. Do it right away; otherwise, you could be subject to the penalty.

New technologies in retirement plans. The Treasury and DOL can issue guidance on new technology through means such as voice response systems, e-mail, the Internet, and an intranet. People will be able to do elections via the computer. They can give instructions on their 402(f) notices via computer or via voice response systems. That will be something for which they will have to issue guidance. I did not see that on the agenda of items that the DOL is looking at, but that's down the road as well.

Let's move on to 401(k) plans. There is a diversification requirement. If I had a company that sponsors a 401(k) plan and mandates that a percentage of an employee's contribution must go to the company's securities, I need to pay attention to this law because it deals with the 10% of pension plan assets and invests it in company securities and wraps them all together. There is an exception. If the total assets of all individual account plans of the employer did not exceed 10% of the total assets of all pension plans, then this doesn't apply. This applies to elected

deferrals and years beginning after December 31, 1998. This only applies if it's a mandated issue in which the employer says the employee has to put 1% or 2% of the elected deferrals in the company stock. It doesn't do anything with matching contributions.
From the Floor: There are five exceptions. I think the general feeling in the benefits community is that this law doesn't have very many teeth . You can get around it fairly easily. The biggest exception is that if the plan is an Employee Stock Ownership Plan (ESOP), then you don't have to pay attention to it and you can convert pieces of a 401(k) plan into an ESOP.

Mr. Dinkin: I don't have too many clients who would mandate that employees put money in company stock.

From the Floor: Actually, my employer mandates that all of my money must go into the employer stock. All of the company money must go into the employer stock too. We were all rooting for this bill.

Mr. Dinkin: It's something to be aware of but nothing to be overly concerned about. Bill, why don't we talk a little about the DB plan changes regarding the full-funding limitations?

Mr. Bush: When ERISA was passed, there was some concern about employers hiding assets in their pension plans and getting excess deductions, therefore reducing the amount of tax that they had to pay. The original version of ERISA had some limits on the amount of money that you could contribute to the plan. They were called a full-funding limit. The test was fairly simple. You took plan assets, and projected them to the end of the year. You then took plan liabilities (defined as the accrued liability under your funding method), and projected them to the end of the year. If assets exceeded liabilities, then there was a potential that the amount of money you could put into your pension plan was limited. What this did was reduce the funding flexibility of the employer.

On the other hand it wasn't too much of a draconian measure, so it was fairly easy for employers to work within this full-funding limit.

With the Omnibus Budget Reconciliation Act (OBRA) of 1987 Congress decided that employers were still contributing too much money to their pension plans, and it elected to reduce further the amount that you could contribute and deduct. It introduced a new method in which it said that you had to use a current liability test. Current liability is a lot like the accumulated benefit obligation (ABO) or the value of accumulated benefits. You have to use a specific interest rate to determine that

value of accumulated benefits. The test is vaguely similar to the original full-funding limit. Take the current liability, project it to the end of the year, take assets, project them to the end of the year, and multiply the liability times 1.5. If the assets exceed that liability, the amount of money you can put into your pension plan is further limited.

I deal mostly with medium- to large-sized corporate plans. For most of them, this was pretty much a nonissue. It didn't have much impact. There are some clients for whom this has a substantial impact. For example, a steel company in Pittsburgh spun off from its old employer. The old employer kept the old pension plan, and the new employer set up a new DB final-average-pay pension plan. They have fairly substantial start-up liabilities, but their ABO, or the value of the accumulated benefits, is quite small. The employer is severely restricted in the amount of money it can put into the pension plan. In fact, it is restricted so much so that a responsible actuary would not recommend as low a contribution as they are committed to make. That's one example where this current liability test can be a real problem.

Another example is if you have a more mature plan that pays lump sums to retiring employees. You value the lump sum using the old PBGC lump-sum rates. You have to value the current liability at the current liability rate which is higher, so you may not be able to fund that plan very well. What can happen and what has happened is that some plans are adversely affected by this law. In addition, the current liability might limit your contribution. The amount of that reduction in the contribution that you can make to the plan is set up in a ten-year amortization base, so after a period of time, you can have a whole series of these basis set up. You can be in a situation where you have been severely limited as to how much you can put into your plan. You will suddenly be required to make a huge contribution. It has sort of a whipsaw effect.

The change in the law increased that multiplier from 1.5 to 1.7. The multiplier starts increasing in 1999 and finally goes to 1.7 in 2005. It also changes the amortization period from 10 years to 20 years for all those little bases that you set up. It lets you change your old amortization bases to essentially a 20-year amortization base. I think most actuaries' reaction to this is that this is a good thing. On the other hand, it's nowhere near enough, and there were still a lot of plans that will be severely and adversely impacted. This is, however, better than a sharp stick in the eye.

Mr. Dinkin: I guess the way I read it also was that on a sort of related provision on the 420 transfers, 420 basically allows you to use excess pension assets as defined, which is using the current liability definition. You can use some of those excess

assets and transfer them to an account within your pension plan to effectively reimburse the company for its cost of retiree medical benefits. There are all kinds of hoops to jump through in addition to meeting that test. Section 420 expires in the year 2000, so I don't think it does anything to help a situation in which I am going to put more money into the pension. From a plan perspective, if somebody has excess pension assets as defined in Section 420 and does sponsor a retiree medical plan, a Section 420 transfer might be something to look at as well. One of the costs of the 420 transfer is that everybody in the plan has to be immediately vested in the year that you do the transfer. Depending on the size of the nonvested benefits in the pension plan, whether or not it's a true cost, you look at your turnover assumption to see in fact that it really does cost you anything at all. It may be worth a second look. I don't understand a whole lot of it, except it doesn't seem to change the percentages very much. I came to the same conclusion.

The next issue deals with ESOPs. The last couple of tax laws have made some changes to ESOPs to try to make them more attractive. The first change was in the Small Business Job Protection Act that dealt with S corporations. We look at the trust instead of a group of shareholders. If I have a lot of employees and I give them stock in the ESOP, they won't blow my S election by causing there to be too many shareholders. I can have up to 75 shareholders and use the ESOP or any trust as a stockholder. Some of the laws here were intended to make the rules a little more relaxed on the S corporation laws.

I think we'll see that the S corporation rules and the C corporation rules for ESOPs will be identical. This may be another planning point for S corporation shareholders looking for ways to liquidate and diversify their holdings. There are a lot of provisions under ESOPs that would make it attractive for a shareholder to sell to one. One of the big attractions under the code is that if I sell my stock to an ESOP and we reinvest the proceeds in what are called qualifying employer securities, in effect, I defer the gain on the sale. I only pay tax when I start to liquidate those funds. Qualifying securities, U.S. corporate stocks, or mutual funds can be set up just for this purpose. These are called 1042 funds, named after the IRC requirement. They also qualify as qualifying employer securities.

The other item that S corporations aren't quite up to snuff on as compared to C corporations is the value of the deduction. If I'm a C corporation and I sponsor an ESOP, I'm entitled to deduct principal payments in addition to interest payments on my loan. Under the C corporation rules I'm able to deduct 25% of compensation; however, in S corporations you are able to deduct only about 15% of compensation via contribution to an ESOP. It's not quite there yet, but you can see this law is

pending to make it a little bit more attractive for S corporations. There is another bill now in front of Congress that will tend to make the gap even smaller.

There are some other provisions in the new tax law. The first one we're all fairly familiar with by now is reduction in a capital gains rate. The capital gains rate is going to be decreased to 20% for shares held more than 18 months and eventually to 18% for shares acquired on or after 2001 that are held for 5 years. The current maximum capital gains rate is 28%. That still applies to shares that are held more than 1 year, but not more than 18 months.
There's an issue here for qualified plans that distribute employer securities. Under the law there is the issue of net unrealized appreciation. When I distribute amounts of employer securities, the issue becomes what do I do with that net unrealized appreciation? How do I report it? From a plan administrator standpoint, what are the tax consequences to individuals? The old rules are somewhat clear on net unrealized appreciation. Once it was net unrealized appreciation it was always net unrealized appreciation. That has sort of been the IRS's interpretation. In fact, their publication 575 says that is always unrealized appreciation; therefore, it's going to be taxed at a capital gains rate. Hopefully there will be some guidance that will clarify this provision. So going forward, an employer understands that they report a profit when they make a distribution involving employer securities.

When I receive a distribution that has net unrealized appreciation in it, everything up to net unrealized appreciation was taxed to me as ordinary income. That's the cost basis that went into the trust. The spread differential between that cost basis and the fair market value was net unrealized appreciation, which is a capital gains item. That's obviously an advantage. So when people are getting distributions in 1998, I imagine that this issue will come up and make these kinds of distributions a lot more interesting. You still have preserved under law the old five-year average at the rate in which I take the distribution out, and for some individuals who were born before 1936, you still have the ten-year averaging at the old rate. There are some capital gain differentials that can be factored in there, so you may want to look at this very closely. From an administrative standpoint, and also from an employee standpoint, this change is needed, although you don't really think about it from an employee benefit perspective.

There are other items that deal with educational assistance programs. The law reinstates and extends the $5,250 exclusion for employer-provided education reimbursement for expenses that occur before June 1, 2000. However, they did not reinstate the exclusion for graduate level courses. That expired on May 31, 1997. I don't know why they did that. They just forgot about it, or maybe it was a

conscious effort. The other two items are sort of small, dealing with employer-provided parking as well as the foreign-earned income exclusion.

The other major change in the tax law deals with IRAs. This goes back to the 1986 tax law that made a conscious effort to determine if somebody was an active participant versus an inactive participant from a qualified plan perspective. Individuals can deduct, under prior law, $2,000 of contributions to an IRA per tax year. If an individual or his or her spouse was an active participant in a taxpayer retirement plan, the $2,000 was phased out for adjusted gross income (AGI) above certain limits. The IRS issued guidance in the early and mid-1980s dealing with active participant laws. Clearly, in a DB plan, it was easy to figure out what an active participant plan was. As long as I accrued some benefits during that year, I was deemed to be an active participant. However, if I was in a DB plan, it wasn't exactly clear what that meant. What eventually came out was if I put money into my own DB plan or the company made a contribution on my behalf, in that particular year I was an active participant. Earnings didn't count. It had to be an actual company contribution. So the issue about active participation still goes on. The law does make several changes regarding the phaseout. The $2,000 phase-out deduction in the 1998 year applies to AGI between $50,000 and $60,000. That means that if it's below $50,000, regardless of whether I am an active participant, I am allowed to make a $2,000 IRA contribution. Once it goes above $60,000, I can't make a contribution. There are different limits in between. These phase-out ranges are incrementally increased over time until they reach the maximum point in 2005.

Another change pertains to married spouses. As I said, if an individual or the spouse was an active participant, then that was the end of it. So even if I wasn't an active participant but my spouse was, we filed a joint tax return, and my spouse could not make an IRA contribution. The law is changed now. It says the married individual who is not a participant in a tax-favored plan, but who has a spouse that is in such a plan, will not be treated as an active participant. The nonactive participant spouse IRA deduction will get phased out if the couple's combined AGI on a filed joint return is between $150,000 and $160,000, so there might be some individuals who can make a qualified deductible IRA contribution.

The biggest change in IRAs has occurred in two areas. One is the so-called Roth IRA and the education IRA. The Roth IRA allows you to make a nondeductible, tax-free IRA. It was named after the individual who came up with it. The qualified distributions, including earnings from the IRAs, are tax-free, so the distributions you make on an after-tax basis are tax-free. The earnings that come out of these IRAs are tax-free. Qualified distributions are distributions that have to be made at least 5

years after the contribution was made and are made because of one of the following: attainment of age 59 1/2, death of the individual, disability of the individual, and the first-time homeowner expenses for the individual.

What does it mean if I have a nonqualified distribution? The earnings are taxable. The law allows you to choose whether you want your after-tax contributions to come out first or the interest to come out later. It seems then you can effectively postpone one of the recognitions of income by electing a specific method like we have under DC accounts for the so-called post-1986 contributions. If you are familiar with the rules, you know that if I have a defined-contribution (DC) plan and an employee makes post-tax contributions after 1986 and takes the distribution out of those accounts, I have to recognize a pro rata amount of earnings. So if I had $1,000 in my after-tax account and $900 was my money and the other $100 or 10% was the interest on those funds, every distribution that I took out of that post-1986 tax account had to have a pro rata amount of earnings. There is not a concept like that in the Roth IRAs yet. There is an overall annual limit on contributions made to all IRAs for a year. They cannot exceed $2,000. Again, they're phased out for individuals with AGI between $95,000 and $110,000 and joint filers with AGI between $150,000 and $160,000.

There are not as many hoops to jump through on a Roth IRA as there are for a regular IRA. For instance, I'm permitted to make contributions to a Roth IRA for individuals who are age 70 1/2 or older, and I don't have to worry about the minimum required distributions under 401(a)(9) for Roth IRAs.

There's also an interesting aspect of Roth IRAs. I am allowed to convert an existing IRA to a Roth IRA. I must have a taxpayer with an AGI of less than $100,000, and that $100,000 is determined without regard to this rollover contribution. What I can do is take my regular IRA, take a distribution, and effectively roll it over. The conversion is unavailable for a married individual filing a separate return. If I make the conversion in 1998, then I'm allowed to income average, in effect, the amounts that would have been includable to my income. I take the income-averaging effect over four years. So it may be worthwhile to examine these Roth IRAs to see if they make some sense. In addition, the 10% early withdrawal tax will not apply to these conversions.

We're going to talk a little bit about ways to avoid the 10% penalty. It seems to me one of the unintended things that happened was I created another vehicle to get rid of the 10% penalty. On January 2, I can take a total distribution of my IRA and roll it over to my Roth IRA, and, on January 4, I can take it all out. Distributions aren't subject to the 10% premature tax if they come out of the Roth IRA. It's a

nonqualified distribution. I don't have to have any earnings for those two days. I imagine there will be some legislative fix, and you probably know about it already.

From the Floor: It's already in the Technical Correction Bill.

Mr. Dinkin: I figured that if I came up with it, somebody else must have. There are some situations that still make sense. If I had an IRA that was only open for a short amount of time, or if I had a large amount of nondeductible contributions or didn't have any need for the IRA funds for a long period of time, this may make some sense.

The educational IRAs have also been implemented. The law adds another nondeductible IRA for education expenses. The earnings are tax deferred. It's again phased out for single taxpayers with income between $95,000 and $110,000 and married taxpayers with income between $150,000 and $160,000. There appear to be no restrictions governing who can contribute to an IRA on behalf of the child for whom the account is established. So I can do it even if I'm over 70 1/2. It might be a good planning point for individuals who have grandchildren or nieces or nephews. The limit is apparently $500 per child. It's not exactly clear yet as to whether or not that's an individual or an aggregate limit for the child. For instance, I have two daughters. One is 2 1/2 and one is 6. Can each of my parents and my in-laws make a $500 contribution for each of them? The rule on the books is it can be only $500 per individual child, although some people are taking a different view. It doesn't seem to make sense to me. It's a way, from a planning standpoint, to transfer money to the next generation.

There is one other exemption from early withdrawal tax to avoid the premature penalty. The law allows exemption from the early withdrawal tax for first-time home buyer expenses or for qualified higher education expenses that can be withdrawn after 1997. This would again only apply to IRAs, and they're not extended to withdrawals from 401(k) plans.

One of the issues is when do I have to fix my plans, and when do I have to amend them? Revenue Procedure 97–41 prescribes how you do this. It basically says I have to do them by December 31, 1999. Keep your eyes on that date. It is similar to what happened in 1986. They kept postponing that date. Tentatively, all the recent tax law changes have to be amended in my plan by December 31, 1999 regardless of the effective date of some of these provisions. Some of them have early effective dates or later effective dates, but it appears you have to make your plan amendments by the end of 1999.

Let's move on to some of the planning issues. I mentioned that one of the planning points was the fact that there are many individuals who have accumulated a significant amount of funds in their qualified plans, such as DC plans, or DB plans. Some are offered cash-outs as a result of downsizing, mergers, consolidations, outsourcing, and the whole nine yards. People have distributions that are either in their IRAs or their 401(k) plans. Some people are choosing to retire before age 59. Others want to access this money for other purposes, such as college planning, buying a business, or whatever. They're looking for ways to get this money, but they recognize that they have this 10% penalty issue. They're willing to pay the income tax. Obviously, if they can avoid that they'd be better off, but they're willing to pay the income tax. They know they have to pay the income tax at some point anyway. So there are some ways to avoid it.

An example would be a client of mine who was just hired as a CFO. He was a CFO at a much larger company. He was making a lot of money. His base pay was about $400,000. He took another job for $125,000. The company had a very rich benefit plan. They had a match on a 401(k) of $2 for every $1 that you put in for the first 6% of pay. He told me he couldn't afford to participate in this 401(k) plan. Here's a CFO of a company telling me he couldn't afford to participate in the 401(k) plan because he didn't make enough money. He had basically over $million in the plan from his other company. He didn't want to pay the 10% penalty tax. I can't afford to live on $125,000 and put in 6% of that. I tried to convinced him of what he was leaving on the table. It would be 18% of pay (6% would be his) on an accumulated tax-deferred basis. He was young enough, and obviously would be subject to the premature penalty tax. We worked out a nice way for him to help fund the college education. It proved to him that he's better off doing this and contributing money to his 401(k). So it takes all kinds.

Let's discuss that 10% tax under Section 72(t). There is a 10% excise tax on distributions from qualified plans, tax-sheltered annuities (TSAs), and IRAs prior to age 59 1/2. There were exceptions to the penalty tax, which are: (1) distributions made after the date the employee attains age 59 1/2; (2) distributions made to a beneficiary; (3) distributions attributable to the employee being disabled within the meaning of Section 72(m)(7); (4) distributions that are part of the series of substantially equal, periodic payments; (5) distributions made to an employee after attainment of age 55; (6) dividends on stock held by an ESOP; (7) payments made to an alternate payee pursuant to a qualified domestic relations order (QDRO); (8) distributions made to reimburse for medical expenses incurred by the participant, spouse, and dependents (as defined in Section 152) paid during the year; (9) distributions from IRAs made to unemployed individuals used to pay health insurance premiums after separation from service; and (10) withdrawals from any

type of IRA before the age of 59 1/2 that are used for first-time home buyer expenses or for qualified higher education expenses (effective for taxable years after December 1997).

Let's discuss substantially equal periodic payments. This is often overlooked when trying to avoid the 10% penalty. The rules say that payments made directly from a qualified plan again may not commence until an employee separates service. I can't modify payments until age 59 1/2 or for 5 years. If I do modify those payments anytime in-between, there is a penalty. The tax code goes back and does an "as if" calculation, penalizing you with an interest payment.

In 1989, the IRS issued three acceptable methods that have been followed in the calculation of substantially equal periodic payments: the minimum distribution method, the amortization method, and the annuitization method. The minimum distribution method annually divides the employee's available benefit as of the evaluation date in the calendar year in which the distribution is made by a life expectancy factor taken from IRS tables. The life expectancy is calculated as of the birthday of the employee in the year the distribution is made. You can look at 1.72–9 of the IRS regulations.

Let's look at an example of the first method. I have an employee who is 56, and he has $750,000 in his IRA. The employee elected to take benefits from his IRA in substantially equal annual payments. He wants payments to commence when he is 57 to avoid the penalty. So he looks at Table 1 and determines that at age 57, his life expectancy is 26.8 years. He assumed an annual return of 8%, used the account balance on the prior year valuation date and found the payment to be $27,985. Then he looked at the IRS tables. The payments cannot be increased or decreased without incurring a penalty. The payments are what they are. Table 1 does not have a payment schedule at age 62 because at that time he or she could stop making payments because that's not the latter of 5 years or 59 1/2. The method may use the life of the participant or may use the joint lives of the participant and a designated beneficiary. The beneficiary does not have to be the surviving spouse. There are no minimal incidental death benefit distribution issues here. This method may produce the smallest amount. It does require you to redetermine the distribution annually, which takes into account the actual investment experience of the account balance. The stream of payments range from $27,000 in the first year up to $37,000.

TABLE 1
METHOD ONE

Age	57	58	59	60	61	62(C)
Life Expectancy (a)	26.8	25.9	25.0	24.2	23.3	
Assumed annual return	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Account balance on prior year valuation date	750,000	782,015	814,383	846,959	879,718	
Payment (b)	27,985	30,193	32,575	34,998	37,756	

The amortization method is the second method where I determine the life expectancy of the individual. Again, I use the life expectancy tables under 1.72-9. I divide the account balance by the number of years of life expectancy using a reasonable interest rate. Once this payment is elected, I don't change anything. I have $750,000 based on the 8% amortization factor in a period of 26.8 years and divide by the annuity factor of 11.78301. The payment is $63,650. The regulation requires the use of the unisex annuity tables (Tables V and VI) as published in the Section 72 regulations. I do not recalculate these every year. The payments determined under this method remain level. Unlike the minimum distribution method, there's no investment experience. The actual investment experience, plus or minus, does not come into play.

The third method is the annuitization method. I divide account balance by annuity purchase rate. Here I have to determine a reasonable interest rate as well as a reasonable mortality table rate. I used the 1984 Unisex Pension Table (UP-84) mortality at an 8% interest rate. I don't recalculate the method every year. I take the $750,000 and divide it by 10.0998 to come up with a number of $74,259. We are going to talk about some of the private letter rulings that deal with how to determine what is a reasonable interest rate and a reasonable mortality rate.

I don't look at actual investment experience. This is a flat level payment. Some individuals are somewhat surprised to see how high the percentage is at younger ages, and how little the difference there is between individuals in their 40s and 50s using this rate. Many people at younger ages thought they shouldn't consider using the pre-59 1/2 distribution amounts. They weren't big enough, and you can see in Table 2 that somebody at age 40 who is using these assumptions gets a distribution percentage of 8.57%. If you're in a situation and you need access to these funds, say for college funds or if you are planning to buy a business, this may be a source that you hadn't thought about before.

TABLE 2
DISTRIBUTION PERCENTAGE
(8.5%/1980 Table)

Age	Percentage
40	8.57%
45	8.85
48	9.06
50	9.23
53	9.51

Mr. Bush: These three examples all use the same starting account balance. They're all the same person?

Mr. Dinkin: Correct. They're all $750,000 divided by 10.098. The highest method is under the annuitization method. It gets a $74,000 in the first year. The next highest is the second method which gets $53,000. As I said, the first one starts out at about $28,000. So the issue here is how much you need, when, and for how long.

From the Floor: You might like the annuitization method because that gets $74,000. Did you say that you can stop for each of the three methods after five years?

Mr. Dinkin: That's right. You can stop after five years or attainment of age 59 1/2. And you don't have to do anything until age 70 1/2. This is something that people often overlook. I have to take those payments out after either the latter of 5 years or age 59 1/2, and then I can stop.

From the Floor: Using your 5 years or 59 1/2 example with a 40-year-old, you would be taking the money out for 19.5 years.

Mr. Dinkin: Yes.

Let's move on to the issue of determining a reasonable interest rate. There is no specific guidance as to what a reasonable interest rate is. The IRS is concerned that if the interest rate is too high, it would be determined over less than life expectancy. There has been issued a series of private letter ruling (PLR) requests. People want to make sure that before they do this that they are going to meet the exception under 72(t). Since the dollars are significant enough, I asked the IRS if this was permissible. There have been several PLRs . Three PLRs included a request to state a specific interest rate. They asked for 8%. Some of the other rulings have said that acceptable interest rates could range from 5% to 10.6%, depending on the specific

circumstances. The IRS has stated informally that it is looking for a rate that has approximated the commencement of the distribution.

Changes in the interest rate assumption during the distribution period have been permitted. PLR 9531039 dealt with that issue, looking at the annuity factor and the attained age in the distribution year, using an interest-rate assumption based on an annual midterm applicable federal rate (AFR). So they elected a method. In this ruling, it appears that the interest rate may in fact be modified, but what they want you to do is spell out a method so you're not doing this hodgepodge.

From the Floor: Is there any experience guidance on how far you can go in using a reasonable mortality table?

Mr. Bush: The question is what mortality table can you use?

Mr. Dinkin: There have been some cases that have attacked actuarial assumptions that deal with one-participant plans and two-participant plans. There have been unreasonable assumptions, such as the discount rates, mortality tables, and interest-rate assumptions. So that would be the only guidance other than these that I'm aware of.

From the Floor: I think the 401(a)(4) regulations also list standard mortality tables that you can use to do your nondiscrimination testing. Those are probably OK.

Mr. Bush: I would think that you could use any of the modern tables like the 1983 Group Annuity Mortality (GAM).

Mr. Dinkin: I guess your question is if I wanted to be more aggressive, how aggressive can I get?

Mr. Dinkin: The question is whether the dollar amount is significant enough and do you want a PLR? I doubt it. Too much too soon. In your scenario, I'll take as much as I can out and have it all exhausted in four or five years as opposed to stringing it out over a longer period of time. My gut feeling tells me I wouldn't get too excited about that.

Mr. Bush: I thought 72(t) was one of the laws that encourages using this money for retirement. The earlier it is taken out, the less likely it is that it's being used for retirement. I thought the IRS might be concerned if you're taking out a lump sum that they wouldn't allow before 55.

Mr. Dinkin: Good point.

From the Floor: I have one final question. From reading your outline I don't get much of a sense that we've been told anything at all. The answers just appear to be all over the place.

Mr. Dinkin: Unfortunately, the only guidance I mentioned was that Q&A from 1989. I pulled that out because there are no other regulations governing this at all. There is some guidance out there.

The other issue deals with aggregation of IRAs. You are probably familiar with the minimum distribution requirements under age 70 1/2. Under those rules I am required to aggregate all my qualified plan, for purposes of determining my minimum distribution. Under the 72 (t) exception there is no requirement to do that. I don't have to aggregate all of them. I can just choose one of them and take one of the distributions. This is clarified in a 1989 PLR and a 1990 PLR. It says it doesn't require plans to be aggregated to calculate series of substantial equal periodic payments. I might have three or four different IRAs. One might have $250,000, or another might have $750,000 or whatever, and I only want to achieve one target. I can try to pick and choose which IRAs I want to take my money out of. The other PLRs deal with the issue of aggregating some and not others for purposes of determining an exception to the rule.
Let's discuss distributions attributable to the death of a participant. One of the exceptions for the pre-59 distribution is if the participant dies. There is a PLR that looks as if it creates a potential trap. Under this ruling a spouse could withdraw a death benefit from the IRA with no 10% penalty, but what the ruling says is that by withdrawing any benefits penalty-free, the spouse is making an irrevocable election not to treat the participant's IRA as wrong. As a result, by taking out even $10 from the IRA prior to 59 1/2, the spouse is then forever prevented from rolling over the remaining balance to a spousal rollover IRA. Using the spousal rollover would mean that the spouse would not have to commence required distributions until she turned 70 1/2 instead of in the year when the participant would have been 70 1/2. Other than that, that exception is pretty easy to follow, I guess.

The other type of distribution deals with distributions attributable to the disability of the participant. Disability is generally defined as the inability to engage in any substantial gainful activity by reason of any medical, physical, or mental impairment. The issue here is whether or not I'm in fact disabled. This is an issue the existing qualified plans that have disability provisions have to prove. Is the participant disabled under the general rule that dictates what that is? There's a PLR that dealt with that issue. The IRS declined to determine whether or not somebody

was in fact disabled. There's a court case, *Dwyer v. Commissioner,* that deals with the 72(t) exception. The tax court ruled that Mr. Dwyer could not claim that a withdrawal from his IRA was exempt from the penalty tax, even though he had been diagnosed with clinical depression. During that period, he continued to engage in his primary business as a stockbroker. Although the trades resulted in a loss, the fact that he engaged in an activity with the intent to generate a profit signified that he was engaged in a substantial gainful activity.

From the Floor: How does the rollover effect the estate taxes? Does it remove the money from estate taxes?

Mr. Dinkin: The question was, how does the spousal rollover effect the estate taxes? Do you mean what happens if I pass it directly to my spouse upon my death?

From the Floor: Yes.

Mr. Dinkin: Correct. It then becomes property of the surviving spouse's estate. The final exception is dealing with the distribution made to a participant after separation from service after age 55. This exception does not apply to IRAs and only applies to other qualified plans. People think they can leave their company at 55 or 56, take the money and roll it over, and eventually, at age 58 take it out of their IRA and exempt it from penalty because they retired early. That can be done if it is a distribution from a company-sponsored qualified plan. The last two items are dealing with distributions that are taken to reimburse medical expenses. It is also for distributions made from IRAs for unemployed individuals used to pay health insurance premiums after separation from service.

These exceptions are fairly straightforward. They have to be the medical expense item, and they have to be in fact medical expenses under Section 213. The last item that was added by the Taxpayer Relief Act of 1997, Section 213 dealt with the first-time home buyer or for qualified higher education expenses. These are for distributions after December 31, 1997. Bill is going to talk a little bit about the changes on 415(e).

Mr. Bush: I won't spend a lot of time talking about how the 415(e) rules work prior to the recent tax law changes. I assume you all know how those work. Suffice it to say that there is a maximum benefit from a DB plan that's currently $125,000. There is a maximum annual addition amount to a DC plan of $30,000. The IRS has some way of combining those two if you happen to get both of them from your employer. The recent law change will eliminate the combined limit. It will be taken away permanently. You can have both the maximum $125,000 annual

benefit from your employer as well as the $30,000 annual addition to your DC plan.

So what does this mean? Say an employer has a DB plan as the primary plan; in other words, if you're limited by 415(a), the employer is supposed to indicate which plan is reduced first. That's the secondary plan. If your DC plan is your secondary plan, you ought to advise your client to make the DB plan the secondary plan because in 2000 when this change takes effect, you'll get back all those DB pieces that your client lost. Employers that have a DB or a DC excess plan may find that some of their benefits in the year 2000 will be shifted from their nonqualified plans to the qualified plan. Presumably, that's a good thing because the benefits will be more secured and prefunded. I believe there is an opportunity to increase benefits for people who have already retired. If someone has retired and the person's benefits have been limited by 415(e), then it's my understanding you can change the plan document so that it says future increases in 415(e) limits will be translated into benefit increases for retired individuals. Then, in the year 2000, when this combined stuff goes away, the employee could potentially get a big bump in his or her retirement DB.

Are there any cautions? One is that the change doesn't quite take place until the year 2000, so the employer needs to be cautious and pay attention to applying the 415(e) limits between now and then. The other caution is that the regular limits continue to apply and that the total 25% of covered payroll limitation for the employer applies. I think this sounds too good to be true. You wonder if there could be trouble in paradise? I think the answer is yes there could be. That is because the combination of the reinstatement of the 15% excise tax on excess distributions and the elimination of the 415(e) limits was considered to be tax-neutral by the IRS. The Taxpayer Relief Act made the 15% excise tax elimination permanent. The IRS had subsequently said, "That changes the rules. This isn't how we understood it was supposed to be. We don't think this is tax-neutral." They're rattling their saber and thinking we need to change either the 15% excise tax or the 415(e) elimination. You need to change one of those two. One of them may be taken away in the future.

Mr. Dinkin: The issue you talked about with the retroactive increase for 415(e), is that something that happens automatically, or do I have to amend my plan? Can I prevent it if I want?

Mr. Bush: My understanding is that your plan has to have explicit language that will allow you to increase the retiree's benefit every year as the 415 limit goes up.

Mr. Dinkin: So absent any language you can't do it.

Mr. Bush: Right.

Mr. Dinkin: The only other point I'd add is that it is still in effect for several more years, so we still have to test for compliance. Even if you found after the law changed, that you have a pre-2000 failure, you still have some exposure. So you could still be audited in the year 2001 or 2002 for a 1999 failure. It's important to maintain those records and do the testing unless the law changes again.

From the Floor: I have a law firm as a client. We have to strongly encourage some senior partners to "retire." They're not ready to retire but they're "of counsel." Of counsels are not covered under the plans, but they are still employees of the employer and are still receiving compensation. It is reduced, but they are still receiving compensation. I believe that their 415(e) fraction continues to rise as long as they maintain an employment relationship and receive compensation from the employer.

Mr. Bush: I would agree, but I'm not an attorney. Is this a partnership?

From the Floor: No, it is a professional corporation (PC). A full PC.

Mr. Bush: Yes, I think you're right. They're still employees. They just don't happen to be participating in the plan.

From the Floor: It's a large firm, and the partner of the pensions agrees with me, so that's what we're doing. It helps on the security side because as these benefits rise their nonqualified benefits go down.

Mr. Bush: Exactly. So his benefits become more secure.

Mr. Dinkin: The last item we want to go over is dealing with worker classification issues. This has had a lot of recent press because of the Microsoft case. There was also a DuPont case several years ago. Were we properly withholding and properly recording income employment tax? It has only been recently that a lot of attention has been focused on consequences of making a wrong decision from a employee benefit provision.

I'd like to go through some of the significant issues regarding an employee versus an independent contractor status. If I'm an employee and I have employment taxes, under the Federal Insurance Contributions Act (FICA) rules there is a specific

amount that has to be withheld from my wages and turned over to the government. It's based on the FICA laws, and it's 7.65% up to the first $68,000. And then there's the health insurance (HI) piece that continues at 1.45% forever, no matter what your wages are. That amount is paid for both the employer and the employee. The employer is also responsible for the Federal Unemployment Tax Act (FUTA) taxes. Employers are required to withhold income taxes from an employee's wages. If I in fact am liable to transfer those taxes over and I don't properly withhold collect and pay, then I am subject to penalties. That has always been a concern for employers just from the payroll tax standpoint of making a mistake if somebody was misclassified as an independent contractor. Employers worry that they didn't pay FICA or FUTA, they didn't withhold properly, they didn't collect, and they didn't return it over to the government. That was always a major concern.

On the flip side, if I'm an independent contractor, I am going to pay my own self-employment tax—the Self-Employment Contributions Act (SECA) piece of it. The self-employment tax is basically in addition to income taxes. It is akin to FICA. The rate is substantially equivalent, so there is really no difference there. As an independent contractor, I would not really be escaping anything. From a reporting standpoint, employers are required to file a form W-2, and I have to report the wages. Again, if I didn't do it properly I have another failure, which is a failure to report on a form W-2. So the penalty issues from the employer perspective continue to accumulate from a reporting standpoint. If I'm an independent contractor and I'm doing work for a whole bunch of companies, I have to hope that they are sending me 1099 forms to the extent that they exceed the services I provided, which is generally $600. Those individuals who didn't send me a 1099 can be penalized, but it really doesn't affect me. I'll just pick it up on my tax return anyway because I know I earned the money.

From an income tax standpoint, there are business expenses that an independent contractor may be able to deduct for conducting a trade or business. As an independent contractor I can use those to offset my income taxes. I may have a home office deduction. Independent contractors can tend to do that in a much easier way than an employee. Independent contractors aren't provided an office like regular employees. If an employee is given an office they are generally precluded from taking the home office deduction for that part of it. That home office deduction basically allows me to deduct a percentage of the cost of operating my home, utilities, and depreciation; I can even deduct part of my gardener fees. Those expenses are based on the square footage of my house. A certain percentage of the total square feet is applied to all those expenses. I can claim those as a deduction. I can also depreciate my house.

Insurance issues are also of interest to an independent contractor. An employer can deduct the amount it pays for the health insurance of an employee that is an ordinary and necessary business expense. If I'm self-employed and an independent contractor, up until recently I wasn't able to deduct a lot of my premiums, but over time that's going to be phased up to a 100% benefit beginning in the year 2007.

Retirement plans is where we start to get into some issues of significance. An independent contractor can establish a retirement plan based on the net profits for the business. However, I can't do that from company to company. I can't cover independent contractors in tax-qualified plans. I can have nonqualified deferred compensation for an independent contractor as well as an employee. If I work for a company, and they want to give me some kind of a deferred compensation type of arrangement. I can do that as an independent contractor as well as an employee.

Let's get into some of the definitions. Over time this has been a little muddy. It started in 1978. There was Section 530, which dealt with a lot of issues dealing with the classification of workers and whether or not to treat them as independent contractors. That was solely for purposes of employment tax consideration. Subsequent to that, we started to get into the classification of employees versus independent contractors for a qualified plan. The code definitions of *employee* are limited to the employment tax provisions. There was a case in 1992, *Nationwide Mutual Insurance Company v. Darden*. The Supreme Court held that for purposes of an ERISA case, an employee is defined using a common law standard, whatever that is. In the *Darden* case, the IRS took the same view, using the testing under the Section on 3121(d)(2). They said it applies for purposes under the entire revenue code, including the employee plan benefit provisions.
Let's talk about issues for qualified plans resulting from misclassification. First, there are the coverage and participation tests. If I misclassify an employee as an independent contractor, I could cause a plan to fail to satisfy the Section 410(b) requirement. There could be an accrual of benefits issue. Workers who are determined to be employees must be given benefit and vesting accrual under the qualified plan if they are otherwise covered under the terms of the plan. If I thought somebody was an independent contractor and that person was an employee, I might not properly accrue benefits for them.

What about eligibility for distributions? I have a pension plan or 401(k) plan that properly commences distributions when somebody separates from service. We all know a situation where an individual retires, begins receiving benefit distributions or 401(k) distributions, and then shows up a month or so later as an independent contractor. He or she might be doing the same thing. He or she might be supervising employees, but he or she has already commenced receiving

distributions from a qualified plan. This is a problem because the individual might not have separated from service. The IRS could challenge that. As a result, many companies are looking at their policies and procedures to make sure that there is in fact a bona fide separation. Both their medical plans and their 401(k) plans specifically exclude these types of individuals. They are trying to make sure that the job of the independent contractor, if you will, is somewhat different than it was before he or she left employment. What about exclusive benefit issues? A plan that covers nonemployees violates the exclusive benefit requirements of a plan. The reverse could happen where a worker establishes his or her own qualified plan, but is subsequently termed to be an employee.

Let's look at what happened in the *Vizcaino v. Microsoft* case. When Microsoft first started, it hired some employees. Then the company subcontracted large groups of people to do a variety of tasks for the company. They felt there was a demand to do this. They thought it might be temporary. We all know the Microsoft story. These people were there for a very, very long time. In fact, they ended up supervising real employees. When these people were hired, they had a contract that specified what they were eligible for and what they weren't as far as the company benefits. The IRS comes in and first challenges that arrangement on an employment tax purpose. Microsoft lost that end of it.

The second rush, if you will, was on the employee benefits. It has gone through a couple of different appeals. Microsoft had, in part of its qualified plans, a 401(k) plan. It also had a Section 423 plan and its own set of rules and requirements. The Section 423 plan allowed individuals, who were eligible to participate in that plan, to buy Microsoft stock at a discount. The plan, as long as it was offered to all employees, met the Section 423 requirements. The court has remanded that to a lower court to figure out how to make those people whole for not being able to participate in the Section 423 plan. It was like saying we want to go back to the plan administrator one more time and determine whether or not these independent contractors/employees were in fact eligible to participate in the 401(k). They started the whole process over again. We're waiting to see what happens if the plan administrator says they are or are not eligible, and what could happen to that plan.

The issue is only significant if your company has a large group of temporary employees or outside contractors who follow the practice of hiring a lot of retirees. There is an issue if companies are decentralized. I don't know what's happening to subsidiaries around the country. They may in fact be doing this process without realizing what could be damaging the company plan. It could come up in audit. It starts with a payroll audit on the W-2s and the 1099s and retirement plan distributions. So it's worth reviewing. The IRS is now focusing on the financial

control and the behavioral issues. There are some other provisions in the Small Business Job Protection Act that hopefully clarify who is an independent contractor. I would tell everybody to ask this question as part of your consulting and as a part of your evaluation process, if you will. If you're collecting data, just ask the question to sort of raise the issue.

As a final word, some of the interpretation of these cases would be that Microsoft was probably better off by excluding these people rather than including them. Had they included them and then later determined that they were independent contractors versus employees, the plan would have been totally disqualified. By excluding them they may have some partial defects that can be fixed. The general rule seems to be that if you're not sure, it's better to exclude rather than include. There is an issue that the court cases did not address. Let's say that I want to hire an individual, and I have that person sign a contract that states what the provisions are under which he or she is being hired. I give that person a list of what I'm going to give and not give. Can that override what the tax-qualified rules say and what ERISA says? The opinions don't really deal with that conclusion. They sort of dodge the issue. You can forget that contract. These people are real boná fide employees and you are left with the damage.

Mr. Bush: I wanted to point out two things. The Small Business Job Protection Act did make two changes that are fairly significant. It gave the employer a safe harbor method of defining who is and who is not an independent contractor. If you follow certain rules you can be pretty sure these folks are independent contractors. That wasn't always the case.

The other thing is it shifted the burden of proof to the IRS. Before the Small Business Job Protection Act, the IRS could come to you and allege that your employees were in fact employees and not independent contractors. You had to prove that they were wrong. Right now, if you meet the safe harbors, the burden is now on the IRS to prove that you're wrong, so it shifted the burden of proof. This is presumed to be good for the employer.