Provided to the Commission by Oppenheimer Wolff & Donnelly LLP

IRS CODE COMPLIANCE BILL SUMMARY

Section 1

Minn. Stat. §354.42, subd. 7 (Erroneous Salary Deductions or Direct Payments)

The IRS generally allows a return of contributions only where there was a mistake of fact and the return is made within one year of payment. This amendment provides that where the IRS would not permit a return, TRA would instead give a credit against future employer contributions, which is permissible under the Internal Revenue Code (IRC) and results in the economic equivalent of a return of the contribution.

Section 2

Minn Stat. §354.53 (Credit for Break in Service), subd. 1 (Employee and Employer Contributions), subd. 2 (Calculation of Credit), subd. 3 (Eligible Payment Period), subd. 4 (Limits of Service Credit Purchase), subd. 5 (Interest Requirements)

These changes are required to conform the purchase of break in service credit for military service provisions to comply with the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA).

The purposes behind USERRA are: (1) to encourage military service by eliminating or minimizing the disadvantages to civilian careers that can result from military service (*i.e.*, provide job and benefit protection); (2) to provide for prompt reemployment of individuals serving in the military upon completion of military service; and (3) to prohibit discrimination against individuals because of their military service.

USERRA provides that "[a] person who is a member of, applies to be a member of, performs, has performed, applies to perform, or has an obligation to perform service in a uniformed service shall not be denied initial employment, reemployment, retention in employment, promotion, or any benefit of employment by an employer on the basis of that membership, performance of service, application of service, or obligation." 38 U.S.C. § 4311(a). Accordingly, denying service credit for any voluntary extension of military service would be in direct conflict with USERRA.

An employer reemploying an employee after military service must: (1) fund any obligation of the plan to provide benefits for the employee as if the employee had been continuously employed during the period of military service; and (2) make employer contributions for the employee in the same manner and to the same extent as the employer did for its other employees during the period of the employee's military service.

An employee who is reemployed pursuant to USERRA is entitled to accrued benefits that are contingent on the making of employee contributions only to the extent the person makes payment to the plan with respect to such contribution. The employee's contributions cannot exceed the amount the employee would have been permitted or required to contribute had the employee remained continuously employed. Accordingly, the plans cannot require the teachers

to pay interest when making up the employee contribution to purchase the service credit under the plans. Requiring the payment of such interest in effect requires the employee to exceed the amount the person would have been required to contribute under the plan had the person been continuously employed with the employer throughout the period of military service.

It is reasonably clear in the legislative history that the teachers cannot be required to pay interest. In its report, the House Committee on Veterans' Affairs stated, "No interest or penalty shall be charged on the employee contribution." House Report No. 103-65, 1994 United States Code Congressional and Administrative News 2449, 2469.

For the purpose of determining benefits under the plan, the employer's contribution and the employee's contribution, the employee's compensation is calculated at the rate that the employee would have received compensation but for the military service. If the rate is not "reasonably certain," then the rate is to be determined using the employee's average compensation during the 12-month period before the military leave. This requirement regarding determination of compensation has been incorporated in the proposed legislation.

Section 3

Minn. Stat. §354.533, subd. 1 (Service Credit Purchase Authorized)

This provision deletes a clause that would discriminate against an employee on the basis of military service, which is prohibited by USERRA. Pursuant to USERRA, a person who has performed service in a uniformed service shall not be denied any benefit of employment by an employer on the basis of that performance of service.

Section 4

Minn. Stat. §354A.093 (Break in Service to Provide Uniformed Service), subd. 2 (Contributions), subd. 3 (Prorating), subd. 4 (Eligible Payment Period), subd. 5 (Limits on Service Credit Purchase), subd. 6 (Interest Requirements)

For First Class Cities: These changes are required to conform the purchase of break in service credit for military service provisions to comply with the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA).

See explanation under Section 2 of this summary for further information.

Section 5

Minn. Stat. §354A.097, subd. 1 (Service Credit Purchase Authorized)

For First Class Cities: This provision deletes a clause that would discriminate against an employee on the basis of military service, which is prohibited by USERRA. Pursuant to USERRA, a person who has performed service in a uniformed service shall not be denied any benefit of employment by an employer on the basis of that performance of service. *See* 38 U.S.C. § 4311(a).

Section 6

Minn. Stat. §356.611, subd. 2 (Federal Compensation Limits)

This change provides that the limit on compensation that can be taken into account under a qualified plan for benefit purposes under section 401(a)(17) of the IRC will increase with IRS cost-of-living adjustments. It also clarifies that if a member began participating before July 1, 1995, the limit for that member remains the higher pre-July 1, 1995 limit.

As a general rule, a plan does not satisfy IRC section 401(a)(17) unless it provides that the compensation taken in account for any employee in determining plan allocations or benefit accruals for any plan year is limited to the annual compensation limit. *See* Treas. Reg. § 1.401(a)(17)-1(b)(1). Treas. Reg. § 1.401(a)(17)-1(d)(4) provides special rules for the annual limitation on compensation specifically for governmental plans. A transition rule permits a governmental plan to apply the IRC section 401(a)(17) annual compensation limit only to persons who become plan participants after the effective date, as described above.

Section 7

Minn. Stat. §356.611, subd. 3 (Maximum Benefit Limitations and Repeal of IRC section 415(e)

This change reinstates the maximum benefit limits of section 415 of the IRC, updated for changes in the law.

IRC section 401(a)(16) specifically states that "[a] trust shall not constitute a qualified trust under this section if the plan of which such trust is a part provides for benefits or contributions which exceeds the limitations of section 415." In order for a plan to be considered qualified plan under IRC section 401(a), these limits must be provided in the plan document. The IRS will not issue a favorable determination letter to a plan that does not have the IRC section 415 limits stated in the plan document.

Treas. Reg. § 1.415-1(d) provides that the terms of a qualified plan must preclude the possibility that the limitations imposed by IRC 415 will be exceeded. Thus, the terms of a DB plan must not allow a participant to accrue a benefit in excess of the IRC section 415(b) limitation. Therefore, a plan may fail to satisfy the IRC section 415(b) limitations even though no participant has actually accrued or received a benefit in excess of these limitations. See Treas. Reg. § 1.415-3(a).

Treas. Reg. § 1.415-1(d) provides that the terms of a qualified plan must preclude the possibility that the limitations imposed by IRC section 415 will be exceeded. Thus, the terms of a DB plan may not allow a participant to accrue a benefit in excess of the IRC section 415(b) limits and the terms of a DC plan must limit allocations to the maximum allowed by IRC section 415(c). For limitation years beginning before 2000, the terms of a DB plan and a DC plan must provide that where a participant participates in both a DC

plan and a DB plan of the same employer, the combined limitation of IRC 415(e) will be satisfied. IRC section 415(e) was repealed for limitation years beginning on or after January 1, 2000. *See* IRS Notice 99-44, which provides helpful Q&A guidance on implementation of the repeal of the combined plan limit.

For more information on these limits, please consult Internal Revenue Manual 4.72.6 (Section 415(b)).

Section 8

Minn. Stat. §356.63 (Internal Revenue Code Compliance)

Miscellaneous general IRC qualification rules.

Subdivisions 1 and 2 add references to the minimum required distribution rules of IRC section 401(a)(9) that will be required by the IRS in order to receive a determination letter. IRC section 401(a)(9) specifically provides that a trust shall not constitute a qualified trust under IRC section 401(a) unless the plan provides these rules.

Subdivisions 3 through 7 add the eligible rollover distribution rules of IRC section 401(a)(31). IRC section 401(a)(31) provides that a qualified plan is required to contain these rules. In general, IRC section 401(a)(31) requires a plan to permit distributees to elect to have an eligible rollover distribution paid directly to an eligible retirement plan specified by the distributee.

Subdivision 8 states an IRC rule that forfeitures cannot be used to increase benefits in a qualified defined benefit plan. IRC section 401(a)(8) requires that a trust forming part of a defined benefit pension plan must expressly provide that forfeitures arising from severance of employment, death, or any other reason, must not be applied to increase the benefits any employee would otherwise receive under the plan. TRA and SPTRFA satisfy this rule. The IRS requires that this language be in the plan document in order to obtain a determination letter.

Subdivision 9 states that the plans will follow the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA). USERRA applies to the states and qualified plans are required to have this language. This language follows the IRS model plan amendment language provided in Revenue Procedure 96-49, which provides a streamlined way for plans sponsors to amend their plans to comply with the requirements of USERRA and IRC section 414(u).

Section 9

Effective Date. Sections 1 to 8 are effective the day following final enactment. Section 8 has retroactive application as indicated to reflect the effective dates of the related IRC provisions.