UNITED STATES GOVERNMENT

MEMORANDUM

FORM G-115f (1-92)
RAILROAD RETIREMENT BOARD

January 13, 2014
L-2014-2

TO : Walter A. Barrows
Labor Member

FROM : Karl T. Blank
General Counsel

SUBJECT: Reductions to Supplemental Annuities for 401(k) Distributions

This is in response to your request of September 26, 2013 for a legal opinion regarding the reduction of the supplemental annuity for a 401(k) distribution. As discussed below, it is my opinion that 401(k) plans should not be considered supplemental pension plans as defined by section 2(h)(2) of the Railroad Retirement Act and therefore, employee supplemental annuities should not be reduced due to the receipt of 401(k) distributions.

I. Background.

At issue is section 2(h)(2) of the Railroad Retirement Act (RRA) (45 U.S.C. § 231 et seq.) which provides in relevant part that :

> The supplemental annuity provided an individual by subsection (b) of this section shall, with respect to any month, be reduced by the amount of the supplemental pension, attributable to the employer's contribution, that such individual is entitled to receive for that month under any other supplemental pension plan. 45 USC 231a (h)(2).

Board regulations go on to define pension plans as follows:

> a) *What is a private railroad pension.* The Board determines whether a pension established by a railroad employer is a private pension that will cause a reduction in the employee's supplemental annuity. A private pension

> for purposes of this subpart is a plan that: (1) Is a written plan or arrangement which is communicated to the employees to whom it applies; (2) Is established and maintained by an employer for a defined group of employees; and (3) Provides for the payment of definitely determinable benefits to employees over a period of years, usually for life, after retirement or disability. Such a plan is sometimes referred to as a defined benefit plan.
> (b) *Defined contribution plan.* A plan under which the employer is obligated to make fixed contributions to the plan regardless of profits (sometimes known as a money purchase plan) is a private pension plan. A plan under which the employer's contributions are discretionary is not a private pension plan under this section. 20 CFR §216.42

As you know, the term "401(k)" refers to section 401(k) of the Internal Revenue Code (26 U.S.C. 401(k)), which sets forth conditions under which plans may qualify for favorable tax treatment. A 401(k) plan does not provide for the payment of definitely determinable benefits to employees over a period of years and therefore, is not a supplemental pension plan under section 216.42(a) of Board regulations. However, a plan under section 401(k) may obligate the employer to make fixed contributions regardless of profits. Regulations of the Internal Revenue Service (IRS) generally define pension plan to include such a fixed employer contribution plan as a "money purchase plan". See regulations at 26 CFR 1.401-1(b)(1)(i) (2013). Broadly speaking, these interpretations of the Internal Revenue Code (IRC) have been the basis for applying the supplemental pension reduction to employees' supplemental annuities if their plan obligates employers to make fixed contributions.

However, the IRS also administers the Railroad Retirement Tax Act, which closely parallels certain provisions of the RRA. In particular, the RRTA formerly included a provision taxes funding the supplemental annuity[1]. In 1999, the IRS published a final regulation defining the term "supplemental pension plan" for the purposes of former section 3221(d) of the Internal Revenue Code (IRC). Section 31.3221-4(b)(2) of 26 CFR provides in part:

> (2) Pension benefit requirement. A plan is a supplemental pension within the meaning of this section only if the plan is a pension plan within the

[1] The supplemental excise tax imposed on employers by former sections 3221(c) and 3221(d) to fund the supplemental annuity account was rescinded effective January 2002 by section 203(b) of the Railroad Retirement and Survivors' Improvement Act of 2001 (RRSIA). See Public Law 107-90§203(b)(115 Stat. 878, 891). While RRSIA section 106 also eliminated the separate Supplemental Annuity Account and provided for payment of supplemental annuities from the Railroad Retirement Account, the benefit offset required by section 2(h)(2) of the RRA was retained.

> meaning of 1.401-1(b)(1)(i) of this chapter. Thus, a plan is a supplemental pension plan only if the plan provides for the payment of definitely determinable benefits to employees over a period of years, usually for life, after retirement. 26 CFR §31.3221-4(b)(2)

In other words, the definition of a supplemental pension plan for purposes of section 3221(d) covered defined benefit plans including money purchase plans. It did not cover non-defined benefit plans (plans that did not have definitely determinable benefits over a period of years) such as section 401(k) plans.

The General Counsel considered the impact of section 31.3221-4(b)(2) of the IRS regulations on the reduction of supplemental annuities in Legal Opinion L-99-20. The General Counsel concluded that although the IRS regulation provided a new definition of a supplemental pension plan which did not include 401(k) plans, the Railroad Retirement Board (RRB) had not changed its definition of supplemental pension plans. Consequently, supplemental annuities paid to individuals who had 401(k) plans which required employer contributions were to continue to be reduced. The General Counsel later provided consistent advice with respect to specific plans in subsequent opinions. See, e.g., L-2000-34 and L-2006-17. However, based on a review of the law and the agency's experience under that interpretation, as explained below, I find that original reasoning for a reduction of supplemental pension due to receipt of 401(k) benefits to no longer be persuasive.

II. Analysis.

Although it is true that the Railroad Retirement Board is bound by its enacting statute rather than the IRC, since the Railroad Retirement Tax Act is part of the same statutory scheme as the Railroad Retirement Act, this Office has consistently advised that the Acts should be read in context of one another. See Legal Opinions L-82-176, L- 90-30, and L-2005-25. The IRS definition of a supplemental pension plan as a plan that provides for the payment of definitely determinable benefits to employees over a period of years is consistent with Board regulations. It also more closely reflects the traditional definition of a money purchase plan referred to in the Board regulations. Again, a money purchase plan may be a pension plan to which employers and employees make contributions based on a percentage of annual earnings, in accordance with the terms of the plan. Upon retirement, the total pool of capital in the member's account can be used to purchase a lifetime annuity. This is distinguished from a 401(k) plan that allows for distributions at the employee's direction rather than the purchase of an annuity. This distinction, that a money purchase plan results in an annuity that provides for definitely

determinable benefits to an employee over a period of years and a 401(k) plan does not, is significant. The mention of a money purchase plan in the Board's regulations indicates that this type of defined benefit plan was what was anticipated as the type of plan which would reduce a supplemental annuity. The IRS clarification of a supplemental pension plan is in keeping with that indication. When reviewed in the relation to each other, it is reasonable to conclude that 401(k) plans were not intended to be considered supplemental pension plans under section 2(h)(2) of the RRA.

It should also be noted that in Legal Opinion L-99-20, the General Counsel discusses the fact that employers affected by the IRC's definition of a supplemental plan may no longer escape the hour tax by virtue of section 3221(d) because such plans no longer qualify as pension plans for purposes of that section. The General Counsel mentions that as long as the Board continues to reduce the supplemental annuities of the employees, it would appear that section 3221 (c) would provide that the employers receive matching tax credits. As indicated by the footnote above, the taxes provided for in sections 3221(c) and 3221(d) were eliminated from the tax code with the passing of the Railroad Retirement and Survivors' Improvement Act of 2001. As a result, the reasoning in Legal Opinion L-99-20 regarding tax credits was mooted.

Reinterpretation is also supported by agency difficulties in administration. The Office of Policy and Systems has indicated that administration of the supplemental annuity reduction for 401(k) plans has become burdensome. Under the current procedure, the reduction effective date is the month following the month the distribution was paid. When there is only one lump sum payment, as originally envisioned and addressed in Legal Opinion L-89-112, there is no issue. But under current 401(k) plans, employees can elect multiple distributions as well as when distributions should be paid and the amount of the distribution. This produces several problems surrounding obtaining 401(k) distribution information. Most railroad employers do not administer their own 401(k) plans and therefore do not have direct access to information regarding distributions. In addition, third party plan administrators are not obligated to inform the employer or the RRB when an employee receives a distribution. If the employee does not inform the RRB when the distribution is paid as well as the amount distributed, the reduction to the supplemental annuity may not be applied timely, likely resulting in a large overpayment.

Finally, I note that elimination of the reduction to the supplemental annuity for 401(k) distributions would have a nominal effect on the trust funds. As you cite in

your memorandum, there were 8,360 supplemental annuities awarded with effective dates in fiscal year 2012. Policy and Systems has estimated that about 4% of the supplemental annuities awarded (around 300-325) had their supplemental annuity reduced for 401(k) distribution. Considering that this population of recipients is declining, eliminating the reduction to the supplemental annuity for 401(k) distributions would not have a significant impact on the trust funds.

The United States Court of Appeals addressed the authority of the Board to determine the amount of reduction of a supplemental annuity for a supplemental pension plan in Brotherhood of Railroad Trainmen v. Railroad Retirement Board, 410 F.2d 353 (3rd Cir. 1969). In that case, for purposes of determining the amount of a supplemental employer defined benefit pension which is attributable to employee contributions, the Board had interpreted section 11 of the Railroad Retirement Act of 1937 to include either deductions from the employee's wages, or a choice between a wage increase or an increase in the employer's contribution toward the pension. The Court of Appeals deferred to the Board's expertise in a matter "peculiarly within its jurisdiction," and consequently accepted that the Board's interpretation of the supplemental pension offset calculation had a reasonable basis in law. 410 F.2d at 357.

Consistent with the Court's decision in Brotherhood for Railroad Trainmen, in my opinion, 401(k) plans should not be considered supplemental pension plans as defined by section 2(h)(2) of the Railroad Retirement Act.

III. Reopening and Finality of Prior Administrative Decisions.

In view of the foregoing advice, the last issue to be addressed is implementation of a new interpretation of section 216.42(b). In this regard, section 261.3 of the Board's regulations provides:

Sec. 261.3 Change of legal interpretation or administrative ruling.

> A change of legal interpretation or administrative ruling upon which a decision is based does not render a decision erroneous and does not provide a basis for reopening.

While the result reached in this memorandum is in fact consistent with the analysis of the Railroad Retirement and Survivors' Improvement Act of 2001 (RRSIA), it does differ from the interpretation of the effect of section 216.42(b) which has been applied to date. Accordingly, the advice provided by this memorandum

memorandum should be applied prospectively as a change of administrative ruling within the meaning of section 261.3 of the regulations.

If prior determinations are to be regarded as final, it remains to resolve whether the advice should be implemented for all future supplemental annuity payments including those based on previous determinations of entitlement, or only for supplemental annuity payments based on entitlement decisions subsequent to this advice. In this regard, I note that Congress has made some changes in entitlement under the RRA effective for "annuities that begin to accrue on or after" a specified effective date. See, e.g., Public Law 107-90 § 102(d)(1) (115 Stat. 878, 880)(full employee tier I payable at age 60 with 30 years service for annuities which begin to accrue on or after January 1, 2002); and Public Law 98-76 § 101(c) (97 Stat. 411, 412) (reduced employee tier I payable at age 60 with 30 years service for annuities which begin to accrue on or after date of enactment). In other instances, Congress has used the date an individual files an application for benefits as the basis for new entitlement requirements. See Public Law 93-445 § 602(a) (88 Stat. 1305, 1360)(new entitlement under the RRA of 1974 effective with applications filed after 1974); Public Law 98-76 § 103(b) (97 Stat. 411, 416)(retroactivity of beginning date shortened from 12 to 6 months effective with applications filed on or after date of enactment).

A common element of the dates which Congress selected in these instances to determine when the amendment would take effect is that they result from the annuitant's action in filing an application or some other pre-determined factor, such as date of birth or service in the railroad industry, which is not controlled by the agency. Although the evidence is that in Congress' judgment either of these methods are equitable, in my opinion in this case I believe the best course is to remove any current reduction of a supplemental annuity based on disbursements under a 401(k) plan effective with the first annuity payment date following the date of this opinion going forward. See Legal Opinion L-2005-09 (applying the rescission of the former railroad retirement maximum reduction to all subsequent annuity payments regardless of application filing date or annuity beginning date). All new supplemental annuity entitlements should also not be reduced for 401(k) plan disbursements.

cc: Chairman

Management Member

Director of Policy and Systems