CHAPTER 2. PRIVATE RETIREMENT PLANS

2-1. INTERNAL REVENUE SERVICE QUALIFICATION. It is strongly recommended that all private retirement plans be qualified under the Internal Revenue Code of 1986 (IRC or Code).

2-2. TYPES OF PRIVATE RETIREMENT PLANS. A HA may consider adopting one or more of the following types of private retirement plans (except as noted):

a. IRC Sec. 401(a) Plan. This is the traditional form of qualified plan provided pursuant to IRC Sec. 401(a). Most HA plans will be of the defined contribution type. Large HAs may adopt a defined benefit plan if actuarially practical. Most plans are provided through an insurance company's prototype plan. In some cases an independent sponsor may provide a master or prototype plan or similar arrangement.

b. IRC Sec. 401(k) Deferred Compensation Plan. As governmental entities, HAs may not establish Sec. 401(k) plans after May 6, 1986. Sec. 401(k) plans established by HAs before this date may be continued, and the effective dates for some of the changes in the Sec. 401(k) requirements are delayed two years for such plans (TRA'86 Sec. 11 16(f)).

c. IRC Sec. 403(b) Tax-Sheltered Annuity. Employees of certain tax-exempt organizations that meet the requirements of IRC Sec. 501(c)(3) are eligible under IRC Sec. 403(b) to exclude from their current gross income amounts paid by their HAs (through salary reduction or otherwise) towards the purchase of annuities or deposits in special custodial accounts in a regulated investment company. The total excludable contribution is limited by law. A tax-sheltered annuity plan may be used as a primary employee-provided retirement benefit program or with HA contributions as well. Amounts excludable from income through salary reduction remain subject to FICA taxes.

d. IRC Sec. 408(a) Individual Retirement Account. In the event a HA does not have a retirement plan for its employees, it may inform them that an individual retirement account or annuity (IRA) is available. No deductible IRA contribution can be made by active participants or their spouses in an employer-sponsored retirement plan, if their income is above a certain level. A married person with income less than $10,000, filing separately, whose spouse is covered by a retirement plan, can contribute to a deductible IRA. "Active participant" is defined as one who participated, whether vested or not, in a private or public employer-sponsored retirement plan for any part of the plan year ending within the individual's taxable year. This includes tax-sheltered annuities and Simplified Employee Pensions, but not IRC Sec. 457 plans. Spousal IRAs are available even if the spouse earns up to $250. Individuals who cannot make a deductible IRA contribution may make a nondeductible IRA contribution of up to $2,000. Those who cannot make the full $2,000 deductible IRA contribution may contribute the remainder of the $2,000 on a nondeductible basis. Earnings on the account will be tax-deferred. IRAs are subject to the same 10 percent tax on early distributions that applies to qualified plans (see paragraph

2-22). Qualified Voluntary Employee Contributions are no longer permitted. These IRA provisions are effective January 1, 1987. Information on IRAs is available through local banks, thrift institutions and insurance companies.

e. IRC Sec. 408(k) Simplified Employee Pension. Under a Simplified Employee Pension (SEP), a HA contributes to an IRA for each participant (IRC Sec. 408(k) as amended by TRA'86 Sec. 1108 and 1898(a)(5)). Thus, a SEP is a kind of defined contribution plan very similar to a Sec. 401(a) plan. A SEP can be an attractive alternative to a Sec. 401(a) plan, particularly for a small HA. A SEP requires no plan document other than IRS Form 5305-SEP, Simplified Employee Pension -- Individual Retirement Accounts Contribution Agreement, no IRS approval, no summary plan description, no annual IRS Form 5500, no summary annual report, no attorney, no actuary and no consultant. The maximum HA contribution under a SEP is the lesser of $30,000 or 15 percent. A SEP maintained by a governmental entity (i.e., a HA) cannot permit elective salary reduction deferrals for any of the difference between the HA contribution and the maximum SEP contribution permitted by law (i.e., the lesser of $30,000 or 15 percent). In tax years beginning after 1986, TRA'86 provides that, as an "active participant" in an employer-maintained retirement plan (the SEP), individuals may make nondeductible contributions to an IRA (which may be the SEP-IRA subject to the applicable IRA deduction limits of IRC Sec. 219(g) (as added by TRA'86 Sec. 1101). Earnings on nondeductible contributions are not subject to Federal tax until they are withdrawn, but when withdrawn the pro rata basis recovery rule applies (see paragraph 2-23). A SEP must cover every employee who has attained age 21, has performed service for the HA in at least three of the preceding five years, and receives at least $300 of compensation in the current year. More liberal participation is permitted. A SEP has full and immediate vesting. Employees are free to withdraw their contributions under a SEP at any time without restrictions but penalties for early withdrawal apply. A copy of each Form 5305-SEP shall be retained in the HA's files. Form 5305-SEP is not filed with IRS.

g. IRC Sec. 414(h)(2) Employer "Pick-up" Plan. Sec. 414(h)(2) permits a governmental entity (i.e., a HA) to "pick-up" mandatory employee contributions and deem such contributions to be employer contributions. These contributions are not taxable to the employee until received. For Federal income tax purposes, the employee's W-2 wages are reduced by the amount of the picked-up contribution. Rulings from the Social Security Administration have indicated that those funds which are obtained through a reduction in employee wages will be considered covered wages for FICA purposes. This means that employees do not lose Social Security coverage. At least three contribution accounts must be maintained and the following conditions observed:

(1) Employee contributions made before the date of the HA pick-up. These must include interest earned. These contributions are paid from after-tax dollars and are not taxable to the employee upon distribution. These are fully vested.

(2) Employee contributions which are picked-up by the HA. These contributions have been paid from before-tax dollars and, together with interest thereon, are taxable to the employee when received. Since these contributions are derived from employee mandatory contributions, they are fully vested.

(3) HA contributions, together with interest thereon, are taxable when received. The appropriate vesting schedule will apply (see paragraph 2-18).

(4) Additional accounts will be required to segregate contributions where more than one type of investment media is provided.

(5) See paragraph 2-23 for treatment of after-tax employee contributions.

Since the employee mandatory contributions that have been picked-up by the HA are maintained in a segregated account and treated as though they were HA contributions, it is possible to provide the prerequisite 100 percent vesting on these contributions without a complex formula. Furthermore, by proper definition of wages, it is possible to consider the employee contributions which are picked-up by the HA to be part of basic compensation. This means that there will not have to be adjustments to employee-HA contribution rates to the retirement plan. In addition, other pay related benefits (e.g., life insurance) can be based on total pay including the HA's pick-up of employee contributions.

h. IRC Sec. 457 Public Employee Deferred Compensation Plan. IRC Sec. 457 provides for Public Employee Deferred Compensation (PEDC) plans on a taxfavored basis (IRC Sec. 457 as amended by TRA'86 Sec. 1107). A HA may adopt a PEDC program for full or part-time employees. There are no age or service requirements and participation is strictly voluntary. A PEDC plan may not use any age later than 70-1/2 for retirement purposes. Employees may voluntarily elect to defer a portion of their compensation to some later date (usually normal retirement age under the plan). Only employee contributions are involved. Before making PEDC contributions, an employee must enter into a participation agreement with the HA. The HA reduces the employee's salary by the designated amount and remits the payment to the insurer. (Note: Only the HA may remit contributions on behalf of a participant to a qualified PEDC arrangement.) With the exception of a "catch up" rule, the normal annual maximum contribution is 25 percent of compensation (before salary reduction), not to exceed $7,500 (TRA'86 Sec. 1107). Under the catch up rule, in each of the last three years before the year normal retirement age is reached under the plan, the plan may permit a catch up amount in addition to the regular maximum amount to be deferred. An eligible employee may participate in a PEDC, a qualified pension plan, a SEP and an IRA (to the extent allowable). By law, the HA is the owner and sole beneficiary under the terms of the PEDC contract. Also, all amounts deferred must remain assets of the HA and are subject to the claims of its general creditors. The employee must file a beneficiary designation with the HA. While contributions generally reduce a participant's gross income for Federal income tax purposes, FICA and FUTA taxes on the contributions must be paid. According to current legislation, benefits become available upon (1) separation from service; (2) retirement; (3) death; or (4) an unforeseeable emergency beyond the participant's control which creates a financial hardship as defined by IRS regulations. IRS does not permit loans. Distributions from Sec. 457 plans are treated as ordinary income and do not benefit from taxation of lump-sum distributions.

2-3. EXPENSES. Routine operating expenses for the administration of the plan may be paid from the basic contribution allowances or from forfeitures, dividends, or other plan assets. Routine operating expenses normally include record keeping, investment expense, commissions or other contract loading, and corporate trustee or administrator fees. The HA may pay for non-routine unusual expenses which are not covered by the insurance company or plan administrator as part of its routine service function. Nonroutine expenses may include an actuary's or legal counsel's fee, IRS user fees, fiduciary bonding, auditing expenses and one-time setup charges. Any such payment shall be subject to prior written approval of the appropriate HUD Field Office and funds must be available or otherwise budgeted. An officer or employee of a HA serving as a trustee-administrator should serve without compensation (but may be reimbursed by the plan for any necessary travel expenses). An individual cannot be the trustee of an IRA.

2-4. EFFECTIVE DATE. The effective date of a plan should coincide with the collection of required employee contributions. Any HA contribution will be subject to HUD budget approval but may be made in advance of final approval where the HA has entered into an escrow agreement (see paragraph 2-30).

2-5. UNDERWRITING. In order to preserve and maintain the retirement plan's assets, it is recommended that the following guidelines be followed. The retirement plan will be underwritten on an accepted actuarial basis. Retirement plan assets will be managed only by a professional money manager, which may include a life insurance company, a corporate fiduciary such as an investment bank, or a regulated investment company such a mutual fund. Plan assets will be deposited in an eligible investment medium. Upon retirement or other termination of employment, unless a lump-sum settlement option is elected, benefits will be guaranteed by a life insurance company or retirement association through the purchase of individual or group policies.

2-6. INVESTMENT MEDIA. Employee contributions (voluntary or mandatory) and HA contributions are usually invested in one or more of the following types of investment media held pursuant to ERISA Sec. 403 and are managed by a professional money manager (see paragraph 2-5).

a. Qualified Insurance Company Contract. These include individual and group qualified policies such as whole life, universal life, retirement income, endowment, annuity, deposit administration, immediate participation guarantee, and guaranteed investment contracts.

b. Custodial Accounts. These may be either a qualified trust or a common investment fund treated as a qualified trust under IRC Sec. 401, including a pooled account of a federally insured bank, trust company or credit union; money market fund; corporate bond fund limited primarily to straight debt securities which have a rating within the four highest grades as determined by an investment service such as Standard & Poor's Corporation or Moody's Investors Service, Inc.; Government bond fund; and mortgage fund (which is classified as an equity fund); and a pooled account utilizing savings accounts, Treasury bills and certificates of deposit. Custodial accounts may also include an equity fund (see paragraph 2-7).

2-7. EQUITY INVESTMENT PLAN. "Equity investment plan" means a dual-funding arrangement. Under the plan, HA and/or employee contributions may be allocated all or in part to an account the assets of which will be invested primarily in common stocks (investment account) or to an account utilized in traditional insurance operations for fixed dollar investments (fixed dollar account). At retirement, account balances may be-converted to provide a lump-sum settlement or a fixed dollar annuity and/or a variable annuity. Each participant may designate the percentage of the total contribution to be allocated to the investment account, and the remainder shall be allocated to the fixed dollar account or other eligible investment medium. A participant should have the opportunity to change the percentage of the contribution which is to be allocated to each account. The investment account should be a pooled account under which funds from more than one source are commingled. The investment account should be invested in accordance with the following policies:

a. Equity investment account assets shall be invested in a portfolio of equity securities, mainly common stocks, diversified over a variety of industries and companies. The portfolio shall not concentrate more than 25 percent of its assets in any one industry nor more than 5 percent of its assets in any one company or issuer, except obligations of the United States Government and instrumentalities thereof.

b. Real estate shall not be purchased or sold as a principal activity. Mortgages are not in and of themselves considered as the purchase of real estate. Real estate trusts, however, are not acceptable.

c. No purchase of commodities or commodity contracts shall be made.

d. Loans shall not be made except through the acquisition of bonds, debentures, or other evidences of indebtedness of a type customarily purchased by institutional investors, whether publicly distributed or not.

e. Not more than 10 percent of the voting securities of any one issuer shall be acquired.

f. Short sales of securities shall not be made.

g. Purchases shall not be made on margin, except for such short-term credits as are necessary for the clearance of transactions.

h. Borrowings shall not be made except for emergency or temporary administrative purposes to an extent not exceeding that permitted by Sec. 18(f)(1) of the Investment Company Act of 1940.

2-8. CONTRIBUTIONS. Contributions may be paid on any periodic basis. Where contributions are paid in advance the plan should provide for reimbursement through employee withholding and for recovery of any excess contribution not due in the event of termination of reemployment. Under the IRC, "contributions" may not be paid in advance to an IRA or SEP-IRA. The plan must specify whether basic or total compensation (i.e., including overtime) will be used in the calculation of contributions and the method of determining this amount. Participating employees may be classified by salary brackets for the purpose of computing contributions. Interest may be paid to employees on their accumulated voluntary or mandatory contributions refunded at death or termination of employment based upon actual investment experience.

a. Basic HA Contributions. The HA may contribute a percentage of an employee's total compensation (including or excluding overtime) to provide retirement benefits.

b. Mandatory Employee Contributions. The plan may provide for mandatory employee contributions. In such event, employees should not be required to contribute an amount which exceeds 6 percent of an employee's total compensation, nor an amount in excess of basic HA contributions.

c. Voluntary Employee Contributions. The plan may provide for voluntary employee contributions in addition to any mandatory employee contributions. These voluntary contributions may not exceed 10 percent of an employee's total compensation over a 12-month period. Deductible Employee contributions are not permitted for plan years beginning after 1986. See also paragraph 2-10.

d. Social Security Supplement. If Social Security coverage is not in effect, HA and mandatory employee contributions, if any, may be increased by an amount not in excess of the Old-Age, Survivors, and Disability Insurance (or FICA) tax rate, exclusive of the Part A Medicare tax, of taxable earnings.

e. Forfeitures. All defined contribution plans must use employee retirement plan forfeitures, refunds, withdrawals, and other credits

as a cash refund to the related Federal program for its share of the previously allowed employee pension cost. Treatment of forfeitures is limited to issuing a cash refund to the Federal program for its share of the previously allowed pension cost or to applying a credit to its allocation of future employer contributions. This requirement is effective for plan years beginning after March 31, 2005.

f. Pick-up of Employee Contributions. Pursuant to IRC Sec. 414(h)(2), a HA may "pick-up" the mandatory employee contributions which would otherwise be applicable to a regular contributory plan and "deem" these payments to be HA contributions under the plan subject to the following conditions:

(1) The employee's compensation inclusive of the contributions deemed to have been picked-up by the HA must not change as the result of the HA pick-up of employee contributions.

(2) The pick-up of employee contributions must apply to all plan participants.

(3) The pick-up of employee contributions must be through an appropriate Board resolution. This resolution must specify that the contributions, although designated as employee contributions, are deemed as being paid by the HA in lieu of contributions by the employee.

(4) The arrangement must meet the requirements of Sec. 414(h)(2) of the Code and related Revenue Rulings.

(5) Employees must be 100 percent vested in account balances attributable to the employees' mandatory contributions which the HA has picked-up.

(6) For all other employment purposes, the HA shall consider the employee's compensation to include the amounts of mandatory employee contributions deemed to be HA contributions.

(7) For FICA tax purposes, the HA must consider amounts deemed to be HA contributions as covered compensation and subject to FICA taxes.

(8) In accordance with Sec. 414(h)(2) of the Code, the amounts paid by the HA and deemed to be HA contributions will not be subject to Federal income tax (or Federal income tax withholding) until paid to the employee. Similar treatment may be afforded on sate income taxes for those states which follow the Federal government's tax return.

2-9. NONDISCRIMINATION REQUIREMENTS FOR EMPLOYER MATCHING CONTRIBTIONS AND EMPLOYEE CONTRIBUTIONS. TRA '86 restricts the amount that may be contributed to plans by imposing an "Average Contribution Percentage" (ACP) test on all plans qualified under Sec. 401(a) of the Code (Tb RA '86 Sec. 1114 and 1117). This test compares the ACP of highly compensated (HC) employees to the ACP of non-highly compensated (NHC) employees. The amount contributed includes employee mandatory and voluntary contributions, plus HA contributions made as result of employees' contributions. For a HA's purpose, a highly compensated employee is any one who, in the current or preceding year:

(1) received compensation from the HA in excess of $75,000,

(2) received compensation from the HA in excess of $50,000 and was in the top-paid 20 percent of all employees, or

(3) received compensation greater than $45,000 and was at any time an officer of the HA.

If no one meets the HC definition above, then the highest paid person is considered to be an HC. Consequently, every HA will have at least one highly compensated employee.

The ACP test is met for any plan year only if the contribution percentage for eligible HC employees does not exceed the greater of:

(1) 125 percent of such percentage for all other eligible employees, or

(2) the lesser of 200 percent of such percentage for all other eligible employees, or such percentage for all other employees plus 2 percentage points.

The ACP test is always met when the contribution guidelines (paragraph 2-8) are followed and no voluntary employee contributions (paragraph (2-8c)) are permitted.

2-10. EFFECT OF VOLUNTARY EMPLOYEE CONTRIBUTIONS ON ACP. Noncontributory and Employer-Pay-All plans are especially sensitive to the ACP test if voluntary employee contributions are permitted. In this situation the ACP test will be passed only when:

(1) the NHCs voluntarily contribute 0-2 percent, and the HCs do not exceed this percentage times 2, or

(2) the NHCs voluntarily contribute 2-8 percent, and the HCs do not exceed this percentage plus 2 percent, or

(3) the NHCs voluntarily contribute 8 percent or more, and the HCs do not exceed this percentage times 1.25.

2-11. PENALTY FOR FAILURE TO MEET ACP TEST. When the ACP test is not met, the excess amount including interest must be paid to the offending HC employees within 12 months of the end of the plan year in which the ACP test was not met. If the distribution is not paid by then, plan disqualification occurs. Because of the potential for disqualification of the plan, HUD strongly recommends that either (1) voluntary employee contributions not be permitted, or (2) if permitted, voluntary employee contributions be limited to NHC employees unless the plan has the capability to constantly monitor the ACP, signal noncompliance, and the ability to distribute the amount of the excess HC voluntary employee contributions (and income allocated to such contributions) for such year before the close of the following plan year. The 10 percent tax on early distributions is not applicable to early distributions required to be distributed to HC employees (TRA'86 Sec. 11117(a)(7)(A)).

2-12. SERVICE CREDIT. Under ERISA, employees shall receive credit for one year of service for each year during which they are classified as regular employees. Employees shall receive credit for one year of service (or portions thereof rounded to the nearest month) for vesting and benefit accruals for each year of continuous employment, commencing with their most recent date of hire during which they were plan participants or regular employees with the present HA or with a predecessor HA consistent with paragraph 2-28. An employee who is reemployed after a break in service may be treated as a new employee except that for purposes of any minimum benefit he/she may receive only one such minimum benefit.

2-13. PRIOR SERVICE CREDIT. HAs adopting a governmental or private retirement plan may make contributions with respect to prior service. Payments to a governmental retirement plan are subject to such system's requirements. However, prior service credit may not be provided through a Simplified Employee Pension. Contributions shall be paid in one or more annual installments based on budgetary considerations.

2-14. ACCRUED BENEFIT. The accrued benefit is the annuity which can be provided by the balance in an employee's account(s) consisting of employee and HA contributions, plus income and other gains and less expenses and other losses. If separate accounts for employee contributions are not maintained, the amount allocated to the accrued benefit from employee contributions shall be the same percentage of the total accrued benefit as the ratio of employee contributions plus interest and less withdrawals bears to the total of HA and employee contributions plus interest and less withdrawals.

2-15. EARLY RETIREMENT BENEFIT. A participant may be permitted to retire early but usually this is not permitted more than ten years before the normal retirement date (as defined in the plan). Early retirement may not be conditional upon a HA's consent. The amount of benefit is the value of the participant's accrued benefit at his early retirement date or at some future date not to extend beyond the normal retirement date.

2-16. LATE RETIREMENT BENEFIT. Upon request, an employee must be permitted to continue employment continued after the normal retirement date. The plan shall provide for the continuance of HA contributions and mandatory employee contributions, if any. The late retirement benefit shall be the participant's accrued benefit as of his/her actual late retirement date.

2-17. DISABILITY RETIREMENT BENEFIT.

a. Immediate or Deferred Annuity. The plan may be provide for payment of an immediate or deferred annuity in the event of disability (as defined in the plan). The amount of basic benefit may be a lump-sum distribution or an immediate annuity provided with an employee's account balance(s) as of the date of disability or payment of the basic benefit may be deferred not later than an employee's normal retirement date.

b. Waiver of Premium. The plan may provide for a waiver of premium in the event of disability. The cost of the waiver of premium provision may be paid by the employee as an extra charge or from the basic contributions to the plan.

c. Supplemental Disability Contribution. A plan may provide for supplemental disability benefits by continuing to pay both HA and mandatory employee contributions to the plan. The HA should make a supplemental contribution to the plan only after all available compensated sick and annual leave has been used by the employee.

d. Recovery. In the event the employee returns to the service of the HA upon recovery, the employee may continue plan participation on the date of reemployment (or next anniversary or entry date, if pertinent). An employee who does not return to the service of the HA upon recovery shall be considered to have terminated employment as of the date of recovery and shall be entitled to a termination benefit at that time. Notwithstanding the above, an employee who recovers, who reapplies for employment within a reasonable period of time and who is refused employment because of the lack of an available appropriate position, shall be 100 percent vested in all employee and HA contributions.

2-18. VESTING. Under ERISA, a participant shall be eligible on termination of employment for any reason to a lump-sum cash settlement equal to the monthly benefit provided with the sum of (1) a participant's account balance attributable to his/her own contributions, and (2) a percentage (the vesting percentage) of a participant's account balance attributable to the HA's contributions to the plan. Alternatively, the plan may provide that a terminating employee may elect to receive a monthly annuity starting on the date the employee would have otherwise been eligible for early or normal retirement. Annuities may be involuntarily cashed out (i.e., paid as a lump-sum settlement) by the insurer if the present value of the benefit is less than $3,500.

2-19. MINIMUM VESTING STANDARDS. IRC Sec. 411 sets forth the minimum vesting standards. Sec. 411 (a)(1) requires that an employee's rights in his accrued benefit derived from his own contributions be nonforfeitable (100 percent vested) at all times. Sec. 41 1 (a)(2) sets forth the rules governing an employee's vesting in rights to benefits derived from employer contributions. TRA'86 amended Sec. 411 (a)(2), effective for plan years beginning after December 31, 1988, by accelerating the vesting schedules. As amended, this section specifies two alternative vesting schedules: five-year vesting, or three- to seven-year vesting.

a. Five-Year Vesting. Under the five-year vesting schedule, a plan will meet the minimum vesting standards if it provides that an employee who has completed five years of service has a nonforfeitable right to 100% of his accrued benefits derived from employer contributions.

b. Three- to Seven-Year Vesting. Under this schedule, a plan will meet the minimum vesting standards if it provides that an employee who has completed at least three years of service has a nonforfeitable right to a percentage of his accrued derived from employer contributions. The employee must be at least 20 percent vested after the completion of three years of service, and another 20 percent vested for each additional year of service, until he is 100 percent vested after seven years of service.

c. Governmental Plans. As an agency or instrumentality of a State or political subdivision, HAs may be exempt from the minimum vesting standards. In the past, many HAs elected to follow HUD policy which provided that, for each year of service, the vesting percentage may be no less than 10 percent and no more than 20 percent for the first four years and with 20 percent for each subsequent year until 100 percent venting was achieved at the end of either five or seven years, as applicable. HAs may elect to adopt or continue this prior HUD minimum vesting schedule in lieu of adopting either the five-year of the three- to seven-year vesting schedules required by Sec* 411(a)(2).

d. Accelerated Vesting. The vesting schedule may exceed the minimum vesting stands. For example, a plan provides that each employee's rights to employer-derived benefits are 100 percent nonforfeitable upon completion of three years of service. This plan satisfies the minimum vesting standards since it meets the requirements of one of the vesting schedules (five- year vesting) for all of an employee's years of service.

e. Changes In Vesting Schedule. If an HA adopts a plan amendment changing the vesting schedule, IRC Sec. 411 (a)(10)(B) requires that employee with a specified number of years of service be allowed to elect to remain under the schedule in effect before the amendment. TRA'86 also amended this section; for plan years beginning after December 31, 1988, employees with at least three years of service

must be allowed to make such an election. However, no election need be provided for any employee whose nonforfeitable percentage under the plan, as amended, cannot at any time be less than the percentage determined without regard to the amendment. The regulations specify a period for making the election.

2-20. REQUIRED DISTRIBUTIONS. TRA'86 establishes uniform distribution requirements for qualified plans, IRAs, Sec. 403(b) plans, custodial accounts and deferred compensations plans (TRA'86 Sec. 1121). Starting in 1989, distributions under all such arrangements must begin no later than April 1, after the calendar year in which the participant attains age 70-1/2, regardless of whether he/she has retired (IRC Sec. 401(a)(9)(C) as amended by TRA'86 Sec. 1121(b)). An individual who receives less than the minimum required distribution in a year will be subject to an excise tax equal to 50 percent of the difference between the required payments and the actual payments during the year (IRC Sec. 4974 as amended by TRA'86 Sec. 1121). But the IRS may waive the tax if the failure was due to a reasonable error and if reasonable steps are take to correct the error.

2-21. TAXATION OF LUMP-SUM DISTRIBUTIONS. TRA'86 Sec. 1122 amended the IRC to replace both 10-year averaging and capital gains treatment with 5-year averaging, which an individual may elect only once during his/her lifetime and only after age 59-1/2. Any such election must apply to all lump-sum distributions that the individual receives during the year. This method of taxation is available only to recipients of distributions from qualified plans. Some exceptions may apply under specified circumstances (TRA'86 Sec. 1122(h)(4)).

2-22. TAX ON EARLY DISTRIBUTIONS. An additional tax of 10 percent applies to all distributions before age 59-1/2 unless it meets one of several exceptions (TRA'86 Sec. 1123). For example, this additional tax applies to distributions from qualified plans, Sec. 403(b) plans and custodial accounts, SEPs and IRAs. The exceptions include (1) amounts paid as a life annuity or as a part of a series of substantially equal periodic payments, (2) amounts paid upon early retirement after age 55, if the employee retires under the early or normal retirement provisions of the plan, (3) amounts that are used to pay medical expenses that are deductible under IRC Sec. 213, regardless of whether or not the employee itemizes deductions, (4) distributions upon death, and (5) payments under a Qualified Domestic Relation Order.

2-23. TREATMENT OF AFTER-TAX EMPLOYEE CONTRIBUTIONS. Under prior law any distributions received before the annuity starting date were assumed to come first from the employee's basis, and no taxable income was received until the employee had recovered all of his/her basis (usually within three years). Under the new IRC rules every distribution is allocated pro-rata between recovery of basis and taxable income. These changes are effective January 1, 1987, but a grandfather clause preserves the earlier treatment for employee contributions made before 1987 for plans which on May 5, 1986, permitted withdrawal of employee contributions before separation from service (IRC Sec. 72(e)(8) added by TRA'86 Sec. 1122(c)(3)).

2-24. DEATH BENEFITS. Upon death, a deceased employee's beneficiary is fully vested in all benefits regardless of source or type. Any post-retirement death benefit will be determined by the method of annuity payment (i.e., lump-sum, periodic, etc.) elected by the participant. Life insurance may be included within or outside the plan (see Chapter 3).

2-25. BENEFITS PAYABLE.Benefits are generally paid monthly under the normal form of annuity unless alternate forms of payment, including a lump-sum cash settlement, are made available. The plan may contain a time limit for a

terminated employee to apply for a benefit after reaching normal retirement age. This may be either five years or any other period which is less than the period prescribed in the jurisdiction after which the funds escheat to the state. The plan may provide that an employee who does not so apply shall be deemed to have died, and the proceeds shall be settled accordingly.

2-26. SPENDTHRIFT PROVISION. Under the Code, employees, beneficiaries, HA's or trustees/administrators may not have the power to anticipate, assign, hypothecate or transfer any benefits or assets of the plan and any contracts provided thereunder may not be sold, assigned, discounted or pledged as collateral for a loan or security for the performance of any obligation or for any other purpose, except as may be permitted by the Code.

2-27. PORTABILITY. Credited service and accompanying liabilities and plan assets may be transferred from one plan to another, provided both plans have been qualified under the same section of the Code and both plans provide for transfer and acceptance. The HA's trustee/administrator and insurer must consent to such an arrangement.

2-28. AMENDMENT. Under the Code, no amendment of a retirement plan may adversely affect the rights accrued by any participant before the amendment. In no event may a participant's vested percentage in the accrued benefit immediately after a plan amendment be less than the vested percentage immediately prior to such amendment (see paragraph 2-19e). If the amendment involves a change in insurance companies or other funding arrangements, cash values accumulated in the prior plan may be transferred to the successor plan. Cash values, however, should not be transferred if there would be a fee charged by either plan for the transfer which would result in a loss which could not be recouped in a relatively short period of time.

2-29. TERMINATION OF QUALIFIED RETIREMENT PLAN. Prior written approval from IRS shall be obtained if the retirement plan is to be terminated. Upon receipt of approval, all assets shall be distributed in accordance with the plan's termination provisions.

2-30. ESCROW AGREEMENT. Subject to prior Field Office agreement (for budget purposes), HAs may enter into an escrow agreement with the insurance company to bind retirement plan coverage pending completion of the retirement plan. Such escrow agreement should specify: (1) the employee and HA future service contributions; (2) the amount of temporary term life insurance coverage, if provided during the escrow period; (3) the effective date of the binder shall constitute the effective date of the plan; and (4) a brief description of the type of plan and coverage to be included. All contributions should be deposited in a fixed investment interest-bearing account for the duration of the escrow period.

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