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Volume 34 | Issue 10 | January 26, 2011

## IRS Provides Guidance on Group Trusts, Puerto Rican Plans

*The IRS has issued Rev. Rul. 2011-1, which updates the rules governing group trusts. The Ruling provides that until IRS issues further guidance the assets of ERISA Section 1022(i)(1) Puerto Rico plans may remain in a group trust and, until December 31, 2011, assets and liabilities may be transferred from a U.S.-qualified plan to a plan qualified under the Puerto Rico Internal Revenue Code without adverse tax consequences. The Ruling also provides that all group trusts must provide for separate accounting for each participating plan and may include, under limited circumstances, the assets of Section 403(b) custodial accounts.*

### Background

Rev. Rul. 81-100 (as modified by [Rev. Rul. 2004-67](#)) allows a group trust to hold the assets of numerous plans without violating the “exclusive benefit” rule. Currently, there is no requirement that a group trust maintain separate accounting for each member plan, although many group trusts do so. Under Rev. Rul. 81-100 group trusts may not include the assets of an Internal Revenue Code (Code) Section 403(b)(7) custodial account (which must hold investments in mutual funds), the assets of a Code Section 403(b)(9) retirement income account of a church, or of a Code Section 401(a)(24) governmental plan.

Employee Retirement Income Security Act (ERISA) Section 1022(i)(1) provides that a trust maintained under a plan that meets the qualification rules of the Code and that covers only participants who are residents of Puerto Rico is treated as if it were a U.S. qualified plan. Many group trusts hold the assets of these ERISA Section 1022(i)(1) Puerto Rico plans.

Generally, the transfer of benefits (assets and liabilities) from one qualified plan to another is not a taxable event. In [Rev. Rul. 2008-40](#) (see our Nov. 18, 2008 [For Your Information](#)), the Internal Revenue Service (IRS) held that where a U.S. qualified plan transfers a participant’s benefits to a plan qualified only under the Puerto Rico Internal Revenue Code, even if the Puerto Rico plan satisfies ERISA Section 1022(i)(1), the transfer is a taxable event to the participant. In addition, the transfer itself could jeopardize the qualified status of the U.S. plan. Rev. Rul. 2008-40 provided transition relief for transfers made before January 1, 2011. Rev. Rul. 2008-40 did not address whether a Puerto Rico plan that satisfies ERISA Section 1022(i)(1) could continue to participate in a group trust.

## Rev. Rul. 2011-1

[Rev. Rul. 2011-1](#) addresses a number of issues affecting group trusts.

- **General Pooling.** Assets of Code Section 403(b)(7) custodial accounts, Code Section 403(b)(9) retirement accounts, and Code Section 401(a)(24) governmental plans, which were all previously excluded entities, may now be included in a group trust with the assets of Code Section 401(a) plans, IRAs, and Code Section 457(b) eligible governmental plans. Their inclusion will not negatively affect the group trust's tax status or the tax status of the participating plans.
- **Code Section 401(a)(24).** Section 401(a)(24) applies to governmental plans that provide retirement benefits. Rev. Rul. 2011-1 makes clear that Section 401(a)(24) covers not only plans that provide pension benefits but also any governmental plan that provides other employee benefits for retirees, such as retiree welfare benefits.
- **Code Section 403(b)(7).** Code Section 403(b)(7) custodial accounts may be invested only in mutual funds. As a result, any group trust that includes assets of a Code Section 403(b)(7) custodial account must be totally invested in mutual funds.

***BUCK COMMENT.** Because a group trust that includes assets of a qualified plan is not likely to be invested totally in mutual funds, the changed rule only serves to clarify that the assets of several Code Section 403(b)(7) custodial accounts may be commingled in a group trust.*

- **Separate Accounting.** The documents establishing group trusts must meet certain specified requirements. Rev. Rul. 2011-1 requires all group trusts to provide for separate accounts and appropriate records to reflect the interest of each plan that adopts the group trust. Thus, each group trust will have to include provisions to account separately for each plan's contributions, disbursements, and allocable investment experience. Because of the "exclusive benefit" rule that applies to the adopting plans, anything that has the effect of directly or indirectly transferring value from one plan to another plan violates the tax rules. However, this does not prevent the exchange of investments within the group trust.
- **Model Amendments.** Rev. Rul. 2011-1 includes two model amendments that group trusts may adopt. Model Amendment #1 provides language that a trust can adopt before January 10, 2012 to satisfy the separate accounting requirement (if the trust does not already specifically provide for separate accounting). Model Amendment #2 provides language to allow the trust to include the assets of all permissible types of plans and sets forth the investment restriction if the trust includes Section 403(b)(7) custodial accounts. Rev. Rul. 2011-1 provides that no new determination letter is required when adopting one or both of the model amendments if the trust instrument provides that any amendments to the group trust instrument will automatically pass through to the group trust retiree benefit plans.

- **PBGC.** When the Pension Benefit Guaranty Corporation (PBGC) becomes trustee of a plan, it frequently leaves the plan's investments in the existing group trust until it can move the assets to its commingled trust funds. Even then, it may invest through a group trust. Rev. Rul. 2011-1 provides that a group trust may treat the PBGC investments the same as plan investments.
- **Puerto Rico Plans.** Because the IRS still has not determined whether the assets of Puerto Rico plans that satisfy ERISA Section 1022(i)(1) may be included in a group trust, Rev. Rul. 2011-1 provides that a group trust will not fail to satisfy Rev. Rul. 2011-1 merely because the group trust includes the assets of an ERISA Section 1022(i)(1) plan as long as –
  - The plan was participating in the group trust as of January 10, 2010, or
  - The plan holds assets that had been held by a qualified plan immediately prior to the transfer of those assets to the ERISA Section 1022(i)(1) plan pursuant to the transition relief in Rev. Rul. 2008-40. (Rev. Rul. 2011-1 extends the transition relief to January 1, 2012.)

***BUCK COMMENT.*** *The Puerto Rico plan issue affects both the IRS's international tax group (involved with treaties) and IRS's employee plans group. Because of the overlap, it is likely that the IRS will not be issuing guidance for some time.*

## Conclusion

The trust instruments for most group trusts are likely to provide for separate accounting for the interests of each participating plan but for any that do not, the IRS model amendments are an easy way to comply with the new requirements. The extension of relief for ERISA Section 1022(i)(1) Puerto Rico plans is welcome news and allows sponsors to wait until they have guidance on whether Section 1022(i)(1) plans may continue to participate in a group trust before having to decide whether to transfer assets from a qualified plan to a Section 1022(i)(1) plan.

Buck's consultants are available to answer your questions about Rev. Rul. 2011-1.

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*This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.*