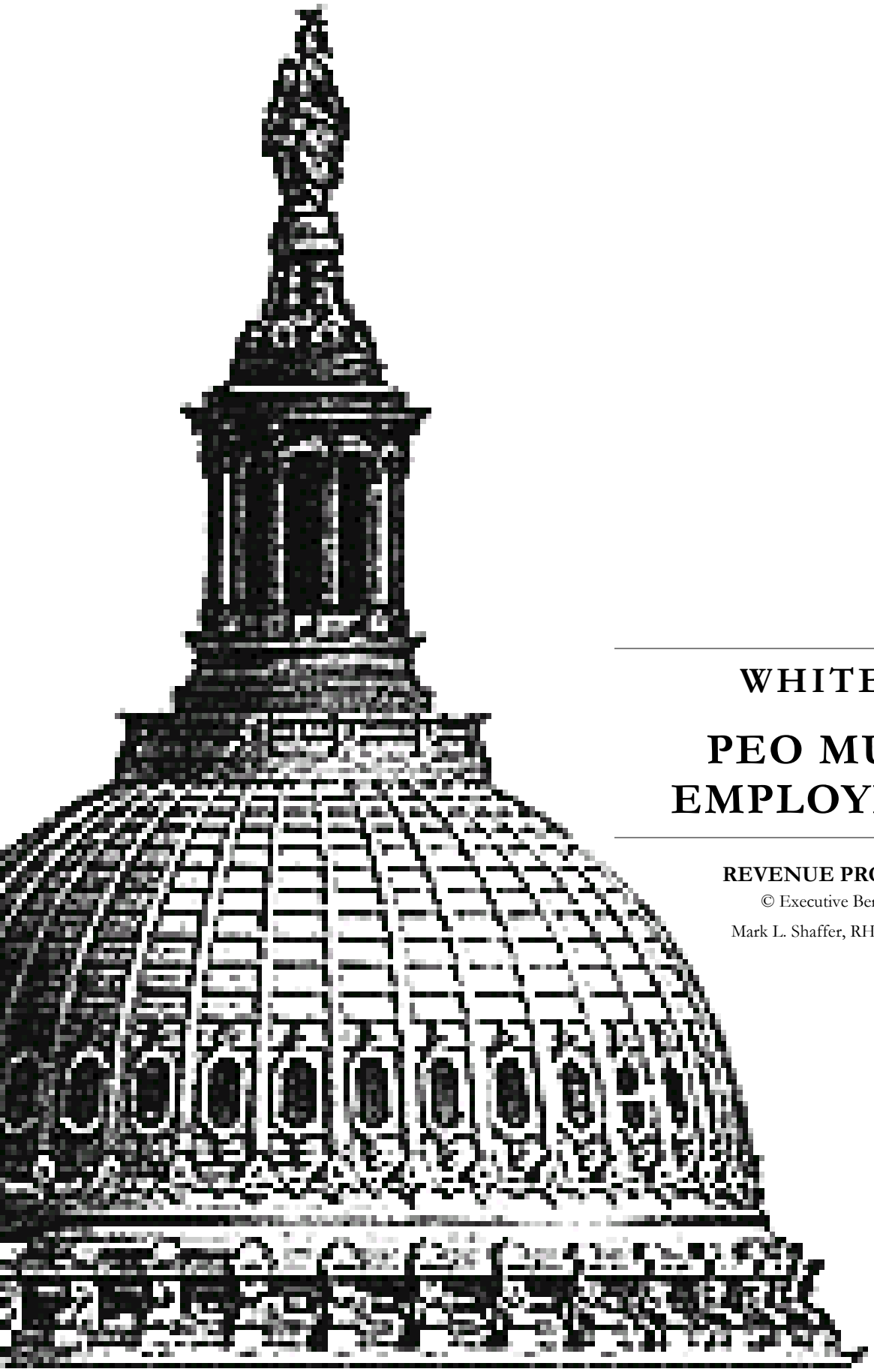

EXECUTIVE
Benefit Plans, Inc.

WHITE PAPER

PEO MULTIPLE EMPLOYER PLANS

REVENUE PROCEDURE 2002-21

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EXECUTIVE BENEFIT PLANS, INC.

PEO MULTIPLE EMPLOYER PLANS

AN INDEPTH FOCUS ON REVENUE PROCEDURE 2002-21

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ABSTRACT

In the 1990's, following the advice of consultants from KPMG Peat Marwick, LLC, many of our PEO clients elected to establish more than one single employer plan. This permitted them to establish different 401(k) employer matching options for their client organizations. Plan A might offer one match, Plan B another, and Plan C another. There were several limitations with this scenario, however. For instance, once the client organization opted for a particular plan they could not switch to another plan within a PEO's program. And, all employees of that client organization who elected to participate had to participate in the same plan. While this was not a perfect alternative as there were still underlying compliance issues, no real flexibility in plan design, no year-end profit sharing contributions, it provided a means to an end while PEOs served their clients and waited for IRS guidance.

It's interesting to note that our company, Executive Benefit Plans, Inc., was in the forefront and installed its first multiple-employer (MEP) plan in late 1998. The common law employer argument within the PEO industry was struggling to hold up with the IRS and the courts. Losing this premise was a major issue with respect to the exclusive benefit rule, and whether PEO single employer plans would remain 'qualified' plans. Prior to that, many of the single employer PEO plans installed by our firm were strictly administered with proper testing performed on a client organization basis. This was not always the case however, throughout the PEO industry, causing concern among participant record keepers and the IRS.

Our team worked closely with AccuDraft, a document automation company, to develop a Multiple Employer Plan (MEP) document for our PEO clients. Since plan year 1999, our sole recommendation to PEO clients has been to use the MEP format. We also initiated the conversion for our previously installed single employer plans, to the MEP format in 1999 and 2000, long before the IRS guidance offered in Revenue Procedure 2002-21 was issued on April 23, 2002. The 'Multiple Employer Plan Strategy Team' we assembled worked diligently to provide the PEOs proper guidance through the conversion process in the early years.

This white paper is a compilation of acquired material and the experience of many different 'specialists' throughout these years. It is important for our clients and prospective clients to become familiar with Revenue Procedure 2002-21 as it provides the necessary guidance for PEOs who have implemented and continue to sponsor qualified retirement plans.

Moving forward, whomever you select as your pension specialist, it is imperative that you take action prior to your PEO 'Decision Date'.[1] This strategy should provide you the required time to comfortably resolve the single employer plan issues relating to your PEO by the 'Compliance Date' set by the IRS.[2]

[1] This is 120 days after the first day of the PEO's plan year beginning after 12/31/02. For calendar year plans, this is May 2, 2003. There are several things the PEO must do by this date.

[2] This is the last day of the plan year beginning in 2003. Essentially the process must be completed by this date for the PEO to have relief. For calendar year plans, this is December 31, 2003.

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IRS NEWS RELEASE ON APRIL 23, 2002

IRS PROVIDES RELIEF FROM DISQUALIFICATION OF DEFINED CONTRIBUTION RETIREMENT PLANS MAINTAINED BY PROFESSIONAL EMPLOYER ORGANIZATIONS

WASHINGTON - The Internal Revenue Service today issued guidance intended to assist professional employer organizations (PEOs) with maintaining defined contribution plans.

PEOs are also commonly known as employee leasing organizations. These organizations, a growing industry in the past decade, contract with firms to undertake their human resource and personnel functions. The services PEOs provide may include health benefits, workers' compensation claims, payroll, payroll tax compliance, retirement plans and unemployment insurance claims. The industry's trade association estimates that nationally there are more than 2 million workers employed through these organizations.

Questions have arisen, however, regarding the qualified status of plans maintained by PEOs. If a plan provides benefits for individuals who are not the employees of the employer maintaining the plan, the plan could be disqualified because it would not satisfy the exclusive benefit rule of section 401(a)(2) of the Internal Revenue Code. The exclusive benefit rule provides that a trust forming part of a qualified plan must be established and maintained by an employer for the exclusive benefit of that employer's employees.

In recognition of the complexity involved in determining whether workers are common law employees of a PEO or its clients, the IRS is providing limited relief. This relief provides plan administrators and other interested parties with some certainty that defined contribution plans that are currently being maintained by PEOs will not be treated as violating, or as having violated, the exclusive benefit rule solely because the plan provides benefits to workers performing services for clients.

In this regard, the revenue procedure provides that a PEO that maintains a defined contribution plan that benefits workers of its clients can avoid disqualification for violating the exclusive benefit rule by adopting a multiple employer plan.

For PEOs that do not want to adopt a multiple employer plan, the revenue procedure provides transition rules under which the existing defined contribution plan will be treated as a qualified plan if it is terminated by a date specified in the revenue procedure. The revenue procedure also provides relief for clients with workers currently participating in a plan maintained by a PEO.

Revenue Procedure 2002-21 will be available on the IRS Web site at and *www.irs.gov* and will be published in the Internal Revenue Bulletin 2002-19 on May 13.

SUNGARD CORBEL ANNOUNCMENT ON APRIL 24, 2002

Revenue Ruling 2002-21 – PEO's – Multiple Employer Plans

Today, April 24, 2002, the IRS has released guidance regarding the Qualification of plans maintained by professional employer Organizations (referred to as "PEOs") and other organizations.

In Revenue Procedure 2002-21, the IRS provides relief to Plans maintained by PEOs, leasing organizations, and other Entities which may have inadvertently violated the qualified Retirement plan rules. One of the critical aspects of dealing with PEOs is determining which entity is the common law employer of the individuals covered by a plan. This is an issue that has been addressed by numerous courts, including the U.S. Supreme Court. Accordingly, the Revenue Procedure acknowledges that the determination of common law employee status is difficult, but nevertheless must be done. The Revenue Procedure serves the purpose of reminding ALL entities maintaining plans that the determination of common law employment status is critical to the continued qualified status of the plans.

If a plan covers an individual who is not a common law Employee (e.g., where an individual is covered by a PEO's plan but is not a common law employee of the PEO), then the plan may have violated the rule that a qualified plan can only cover employees. This is referred to as the exclusive benefit rule. The only way a plan can cover individuals who are not common law employees is if the plan is a multiple employer plan. That is, a plan that is adopted by two unrelated entities (e.g., the PEO and the true common law employer of the individuals being covered).

The relief provided by the Revenue Procedure is that the Service will not disqualify a plan due to an exclusive benefit violation if certain corrective action is taken. Either the plan must be terminated or the plan must be amended into a multiple employer plan. A decision as to which corrective action will be taken must be made by the sponsor of the plan no later than 120 days after the first day of the plan year beginning in 2003. The actual correction must be made by the end of the first plan year beginning in 2003.

SunGuard Corbel has served thousands of benefit practitioners nationwide for more than a quarter century. SunGard Corbel provides support and technical knowledge that is second to none, offering education and timely updates that are crucial to business.

Revenue Procedure 2002-21 may be found in the Official Resources section of our Web site. Click here (or copy/paste to your browser): http://www.corbel.com/news/officialresources.asp and select IRS REVENUE PROCEDURES. The corresponding News Release (2002-52) is also located on our Web site in Official Resources. Select IRS NEWS.

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TRANSAMERICA RETIREMENT SERVICES ASSESSES OPPORTUNITY OFFERED TO PEOs BY NEW IRS REVENUE PROCEDURE 2002-21

LOS ANGELES (May 14, 2002) – Declaring the new IRS Revenue Procedure 2002-21 "very, very good news for PEOs – and a wonderful alternative to plan disqualification," Transamerica Retirement Services' Vice President and Plan Compliance Director Emily Urbano spoke out today about the impact the new procedure will have on Professional Employer Organizations (PEOs) that must convert or terminate single employer retirement plans to ensure that only its employees receive benefits offered through those plans.

"For a long time," Urbano explained, "no one has known exactly what PEOs could or could not do to bring single-employer plans into compliance with the exclusive benefit rule. This revenue procedure eases the fear that PEOs have about plan disqualification, and gives them clear-cut steps and a specific timeline to bring their plans into compliance."

Experts at Transamerica Retirement Services estimate that a significant number of all PEOs either offer single-employer plans currently, or have in the past and still maintain frozen single-employer plans, which means that a large segment of the industry is affected by the new revenue procedure.

Under the new procedure, PEOs with plans that benefit individuals who are not their employees may either terminate or convert those plans to a multiple employer plan. "But I can see no good reason for a PEO to choose the termination option," Urbano said. "PEOs with common-law employees will still want a retirement plan, and multiple employer plans offer them a great deal more structural flexibility than their single employer plans did."

Under a multiple employer platform, clients of the PEO can be adopting employers as well as the PEO itself – on behalf of its internal employees. There is no need to maintain a separate single employer plan for the PEO's internal employees.

"With our own market research showing that employees across all age ranges – extending right down to Generation X workers – prefer jobs with acceptable pay and good retirement benefits to jobs with higher pay but no retirement plan, offering a 401(k) plan in their menu of services will help PEOs get in the door at client companies," Urbano declared.

Urbano suggested that PEOs looking to bring their plans into conformance with the new revenue procedure select a plan provider that has a multiple employer platform already in place. "PEOs won't want to wait several months for the provider to get up to speed – doing so could result in delays which could put them at risk of missing their conversion deadline." Transamerica Retirement Services already has received a favorable GUST advisory letter from the IRS for its multiple-employer plan, Volume Submitter, created specifically for the PEO industry, Urbano added.

Transamerica Retirement Services also is preparing sample document packages, for both plan termination and plan conversion, which it will provide to PEO clients and their counsel when the revenue procedure takes effect in mid-May.

With more than 68 years in the retirement services industry, top-ten retirement services provider* Transamerica Retirement Services provides comprehensive 401(k) and profit-sharing plans designed to help businesses establish effective retirement benefits programs. With more than 10,000** plans in-force and more than 500,000 individual participants as of December 31, 2001, Transamerica Retirement Services offers a wide range of products, including 401(k), money purchase, defined benefit and new comparability plans.

Transamerica Retirement Services' retirement planning products and services are offered in 50 states through Transamerica Life Insurance and Annuity Company and AUSA Life Insurance Company, Inc., both members of the AEGON Group, one of the world's largest financial services organizations***.

Information is available to the public about Transamerica Retirement Services toll-free at (888) 706-4015 or at www.TA-Retirement.com.

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* Transamerica Retirement Services' ranking as a top-ten provider is based on information in an April 2001 CFO MAGAZINE report, "CFO Buyer's Guide: 401(k) Providers". This ranking is derived from data on the total number of plans managed by banks, insurance companies, and mutual funds, reporting over $8 billion in 401(k) assets.

** As of December 2001

*** Based on assets (Source: WALL STREET JOURNAL, October 1, 2001)

What is a Multiple Employer Plan?
A multiple employer plan is a plan maintained by a sponsor, usually a professional organization, a leasing organization or an umbrella social service agency, for employers who are related in some way (through membership, funding, etc.), but are not members of a controlled or similar group based on ownership or service.

What Other Kinds of Plans Need to Be Distinguished From Multiple Employer Plans?
Multiple employer plans must be distinguished from multi-employer plans (sometimes called "Taft-Hartley" plans), which are maintained by trade unions for union members who are employed by unrelated employers.

You should also distinguish multiple employer plans from what I call "brother-in-law" plans. There is no legal impediment to having a technically unrelated employer become an adopting employer of a single employer plan. This is easiest to envision when the ownership interest in the adopting employer is too small to require treating it as a member of a controlled group, but it is still related to the plan sponsor by ownership. Nothing in the regulations forbids an employer from aggregating such plans. More problematic is the case where, in my favorite example, a son starts his own company and wishes to have his employees participate in the plan maintained by his father's company. While there is no technical relationship, neither is there any legal reason why the son's company cannot adopt the father's company plan as an adopting employer. In that case, unlike controlled group aggregation, both the plan as a whole and each participating employer must satisfy 401(a)(4). But this is not treated as a multiple employer plan (and should not be, since there is no relationship between the companies) and only one filing must be completed for the aggregated plan.

> *It's interesting to note that Ralph Paladino of AccuDraft wrote this article on July 10, 2000 long before the IRS issued Rev. Proc. 2002-21. EBP continues to use AccuDraft multiple employer documents for most PEO plans.*

How Does a Multiple Employer Plan Document Differ from a Single Employer Plan Document?
The documents differences depend on the following issue: Will participating employers be allowed to vary the terms of the plan as it applies to them?

If the answer is no, the plan will include certain changes in the WHEREAS clause and some additional definitions ("Sponsoring Employer", "Participating Employer", etc.). The changes will also provide for the application of certain provisions (non-discrimination, etc) to each participating employer and other provisions (combined trust) to the plan as a whole. The participating employer adoption agreement is similar to that used by an employer who is a member of a controlled group.

If the answer is yes, however, the plan may require extensive revision to take account of the variable sections. In addition, the participation agreement must be crafted specifically to reflect the permitted variables and will usually include checkboxes to be filled in by each participating employer. This participation agreement is then considered a part of the plan. In addition, the SPD requires the same kind of document modifications to reflect, for each employer, their elections.

There is a lot of misinformation on the proper preparation of these plans. Some document provider's checklists, for example, have a checkbox for multiple employer plans, but there are otherwise no different questions asked regarding the multiple employer plan. If the plan sent to the preparer includes multiple employer definitions and language, the plan might be adequate, but ONLY if the plan has no variables. If there are variables, the plan will be inadequate.

What Variables Might a Sponsor Offer to Participating Employers?
Actually, almost any plan provision may be a variable. But in practical terms such variables are usually limited to contribution allocation method, vesting, and eligibility. They may, however, extend to end of year and 1000 hour rules, normal retirement age, loans, insurance, in-service withdrawals, disability and the like. In addition, in a multiple employer 401(k) plan, some employers may elect matching, and some may elect the new fail-safe contribution provisions (either matching or non-elective).

Since you are administering the plan, you should consider administrative issues in determining which options to provide. Avoid options that require continued administrative oversight, such as disability or in-service withdrawals, unless they apply to all participating employers.

Are There Any Hidden Dangers in Using a Multiple Employer Plan?
One of the most misunderstood rules concerning multiple employer plans is the one, which states that all assets of the plan are available to pay all benefits under the plan. This can be a reason not to set up a multiple employer plan, and at the least, requires a certain vigilance by the sponsor. In a money purchase plan, this problem may be minimal, but one can envision a situation where an employer absconds with a year's contributions to the plan. Were this to happen, a terminating participant of that employer would be entitled to his full benefit and the accounts of other employees would be ratably reduced to pay the benefit.

In a PS or 401(k) plan the risk is even smaller so long as the sponsor insures timely contribution by the participating employers and does not permit anyone except the trustees access to the participant's accounts.

Another concern is that one or more participating employers will violate the terms of the plan or fail the non-discrimination test. If one employer fails, the whole plan fails. This means that care should be taken to insure that all eligible employees are, in fact, participating. It is probably also a good idea to apply the 1000 hour and end of year rules judiciously if the plan contains a large number of very small employers. Since all those with 500 or more hours must be included for discrimination testing, a plan with these rules runs a real risk of getting it wrong. A fail-safe participation provision can, however, solve this problem.

Congress is working on bills, which were submitted, at the suggestion of the IRS. If passed, both of the above rules will no longer apply to multiple employer plans.

How Do I File a Multiple Employer Plan for a Determination Letter?
You cannot use a volume submitter or prototype plan for a Multiple Employer Plan. All filings are done on a Form 5300.

The IRS has reformed the Determination Letter process and fee structure since this article was written. Approved volume submitter documents are now available through a variety of companies.

The filing looks like this: a Form 5300, Schedule Q (aggregated data), 8717 and 2848 for the plan as a whole. Attach a separate form 5300 for each participating employer; completing ONLY questions 1 through 8 (which is essentially the identifying information). The user fees are $700 for up to 10 participating employers and $1400 for 11 to 99 participating employers.

The plan number is 333 for the sponsor and 001 (if it is their only and first plan) for each participating employer.

The sponsoring organization and each participating employer will receive a qualification letter. Please keep in mind that if employees of the sponsor participate in the plan, they are a separate participating employer requiring a modified form 5500 on its own account as well as the sponsor.

So, the most efficient (least expensive) approach to filing is to do these plans as soon as possible to give yourself plenty of time before the end of the remedial amendment period to obtain the maximum number of participating employer adoption agreements. Then do the filing. If the plan sponsor is adding new employers on a regular basis, you will have to re-file as above annually for the new employers.

What Are the Annual Form 5500 Requirements?
In prior years, each multiple employer plan, regardless of the number of employers had to file a 5500 for the plan as a whole, along with a 5500C or 5500R as applicable for each participating employer. This 5500C includes only Questions 1-7a, 9 and 21 (For the 5500R, Questions 1-7a, 8a and 8b). The preliminary instructions for the 1999 Form 5500 have no clear instructions for multiple employer plans. In all likelihood, the final instructions will require to fill in the first page of form 5500 and attach a Schedule T every third year showing participation information for each participating employer.

> *The author's speculation on Form 5500 filing procedures turned out to be very close to the actual IRS guidance issued much later.*

Are there any alternatives to a multiple employer plan?
For larger organizations, particularly business groups (e.g. Association of _____) where there is no actual bond between them, as there is with, for example, a leasing organization, the employer may wish to consider sponsoring a specially designed volume submitter plan. This plan differs from an ordinary sponsorship in that the plan contains all the non – variable provisions plus an "adoption agreement" containing the variable provisions. This differs from a prototype only in that the document includes only the options that are common to the members thus simplifying and shortening the document and the adoption agreement includes only the variables applicable to the specific, thus simplifying and shortening the adoption agreement.

These plans are submitted on a standard Form 5307 for each participating employer at $125 each.

How do I do a multiple employer plan using AccuDraft?
Obviously, you have the ability to prepare your own multiple employer plan by preparing a standard plan and then modifying this as necessary. However, AccuDraft offers a multiple employer plan document, which includes a Plan, adoption agreement, resolution, and SPD, as well as the form 5300 for the plan sponsor.

Please note the intended audience of this article was Actuaries, TPA's, Attorneys, CPA's, and Pension Specialists. We included it so you would gain a sense of how these MEP plans evolved for the PEO industry.

This document is personalized to reflect the options being offered to participating employers. To order a document, complete a standard plan document answer file. Leave blank the answers to any item, which is being offered as an option.

You may also exclude options within a given variable. For example, you may decide not to permit age weighted or cross-tested allocations or offer only 2 alternate vesting schedules instead of 5. To do so, relay this information in your e-mail. If there is no such information, we will assume that all our standard options are available for each variable.

For very large plans, we can automate the participation agreement at additional cost.

How do I do a volume submitter multiple employer plan using AccuDraft?
These plans are offered by AccuDraft, including plan, SPD, and Adoption Agreement, along with filing for the Organization or Associations qualification letter.

The same procedure for ordering your document is used as for ordering a multiple employer plan.

ANALYSIS - REVENUE PROCEDURE 2002-21

The IRS issued Revenue Procedure 2002-21 on April 23, 2002 providing specific guidance for PEOs. This important and defining ruling on the employee staffing or professional employer organization (PEO) industry has broad consequences affecting many issues. This white paper is focused on the Revenue Procedure. The following topics we discuss are:

- Definitions
- Outline for Multiple Employer Plans
- IRS offers relief
- Penalties for noncompliance
- Compliance requirements
- Multiple employer plan requirements
- Strategic questions and answers

Please note this is still a rapidly developing issue. You may expect the IRS, either formally or informally, to issue additional guidance explaining, refining, and perhaps expanding the Revenue Procedure. Additionally, expect the views to change and be refined as we all have more time to work with this important Revenue Procedure.

In simple terms the message of Rev. Proc. 2002-21 to PEOs sponsoring single employer plans is threefold:

1) You may have a serious problem.

2) Most of the potential problems will go away if you follow your pension specialist's instructions. You will either terminate your existing plan or convert it to a multiple employer plan.

3) If you do not, and you are not the common law employer, you will have future problems with your qualified plans. And, you won't be able to rely on a determination letter after 2003.

The consequence of not being able to rely on a favorable determination letter is so serious that few, if any, rational PEOs will forego the opportunity to take advantage of Rev. Proc. 2002-21. Thus, they will either terminate their existing single employer plans or go with a multiple employer plan, whether or not they believe they are the common law employer of their worksite employees.

In this way, the IRS achieves the result of eliminating most single employer PEO plans without having to determine, on a case-by-case basis, whether a given PEO is the common law employer of its workers. The nice thing is that PEOs avoid the consequences of their prior exclusive benefit violations, and thus maintain the qualified status of their plans. It is a smart decision for the IRS because it enforces the law without undue strain on their resources. It is a good decision for PEOs because it gives them a roadmap to move to qualified status. It is a good decision for participants in PEO plans because they are freed from the cloud of potentially having their retirement plans disqualified, with potentially disastrous consequences.

DEFINITIONS – REVENUE PROCEDURE 2002-21

The Revenue Procedure defines several important terms that are critical to understanding it. Amazingly, it leaves undefined its most important term, PEO. It is obvious from the Revenue Procedure that all staffing firms are considered as PEOs, no matter how the style themselves. However, the Revenue Procedure leaves open the question of whether hospitals, for example, could be considered a PEO subject to the Revenue Procedure if they provide workers for nearby clinics. Here are the key terms the Revenue Procedure does define:

Client Organization (CO) - This is the firm that uses the PEO to provide staffing services for some or all of their workers. It doesn't matter how many or how few workers the PEO provides to the CO. In the language of IRC 414(n), the CO is a recipient, and the PEO a leasing organization.

Worksite Employees - These are the workers the PEO provides to the CO. If the CO/recipient were not the common law employer of these workers, and the workers met the other requirements of IRC 414(n), they would be leased employees. True temporary employees, who are likely the common law employees of the PEO, would be classified as Worksite Employees, as well as workers permanently assigned to a particular CO.

PEO Retirement Plan - This is a defined contribution plan (such as a 401(k) plan or profit sharing plan) intended to satisfy IRC 401 or 403(a), sponsored solely by a PEO and covering Worksite Employees. Multiple employer plans and defined benefit plans are not covered by the Revenue Procedure.

Multiple Employer Retirement Plan - This is a defined contribution plan under IRC 401 or 403(a) and IRC 413(c) cosponsored by the PEO and by all CO's with participating employees.

PEO Decision Date - This is 120 days after the first day of the PEO's plan year beginning after 12/31/02. For a calendar year plan, this is May 2, 2003. There are several things the PEO must do by this date.

Compliance Date - The last day of the plan year beginning in 2003. Essentially everything has to be completed by this date for the PEO to have relief.

Effective Date - May 13, 2002. Plans adopted after this date cannot use this Revenue Procedure.

Spin-off Retirement Plan - This is a plan set up to hold the assets and liabilities for Worksite Employees whose CO chose, through action or inaction, to have benefits distributed to participants. It is to be terminated prior to the Compliance Date and assets distributed as soon as possible.

EPCRS - Employee Plans Compliance Resolution System

I. GENERAL OVERVIEW

A. A multiple employer retirement plan is a tax-qualified pension, profit sharing, or stock bonus plan that is maintained by more than one employer under the Employee Retirement Income Security Act.

To be tax-qualified, a multiple employer retirement plan and its related trust must satisfy all of the Internal Revenue Code's qualification requirements that apply to the plans of single employers. In fact, the employees of each employer that contributes to a multiple employer plan, are generally treated as if they are employed by a single employer in applying the Internal Revenue Code's (IRC) requirements relating to:

- Minimum coverage and participation
- Nondiscrimination
- Exclusivity of benefits
- Vesting
- Funding and
- Limits on the deductibility of contributions

Unrelated entities are entities that are not members of a controlled group under IRC Section 1563(a), not an affiliated service group under Code IRC Section 414(m).

B. Plan sponsors adopt a single plan document. Each additional employer will adopt the plan through a joined or participation agreement.

C. The plan must uniformly apply eligibility, vesting, minimum coverage and deductibility requirements to each employer.

1. Coverage and Participation Rules

The employees of each of the employers that maintain a multiple employer plan must be treated as a single employer in applying ERISA's minimum coverage and participation rules employed them. Those rules are applied on an employer-by-employer basis. The rules prohibiting discrimination in contributions or benefits under a qualified plan apply as if a single employer employed all of the plan's participants.

2. Vesting

The minimum vesting rules apply to a multiple employer plan as if all of the employers maintaining the plan constitute a single employer. For example, all of the hours that an employee works for each employer maintaining the plan are aggregated in computing that employee's number of years of service for vesting purposes. Multiple employer plans are treated differently from collectively bargained plans in testing whether there has been a termination, partial termination, or

complete discontinuance of employer contributions so as to require full vesting of accrued funded benefits. In a multiple employer plan, the IRS does not examine separately each group of participants who are subject to the same benefit formula to determine if a termination, partial termination, or complete discontinuance of employer contributions has occurred. Rather, whether one of these events has occurred is determined based on the experience of all of the plan's participants in the aggregate.

3. Funding Rules and Deduction Limits

The limits on deductible employer contributions are applied as if a single employer employed all of the participants in a multiple employer plan.

4. Exclusive Benefit Test

A retirement plan will not be tax-qualified unless it is maintained for the exclusive benefit of the employees (and their beneficiaries) of the sponsoring employer. In making that determination with respect to each employer plan, all of the employees participating in the plan are treated as employees of each such employer.

II. BENEFITS OF A MULTIPLE EMPLOYER PLAN

A. Plan Set-Up Cost for each additional employer adopting the plan is typically lower since the plan document is already in place.

B. The plan can be designed to maintain its discretionary employer contribution. This means that each employer can determine what level of employer contribution to make.

C. Ongoing Administration costs are generally less since there are economics of scale regarding each employer with regard to per participant and asset charges.

If a PEO Retirement Plan in existence on May 13, 2002 complies with the requirements of Revenue Procedure 2002-21, it receives the following relief:

The IRS will not disqualify the plan because of violations of the exclusive benefit rule for plan years before the Compliance Date. This only applies to exclusive benefit rule violations resulting from improperly covering Worksite Employees who are not common law employees of the PEO.

Employees receiving distributions after termination of the Spin-off Retirement Plan or the terminating PEO Retirement Plan will be able to treat those distributions as coming from a qualified plan, even though the plan may have violated the exclusive benefit rule by covering the Worksite Employees.

For purposes of determining whether the spin-off plan or the PEO Retirement Plan (if the PEO decided to terminate it) is qualified upon termination, Worksite Employees may be treated as though they were common law employees of the PEO. Effectively, this allows the PEO, if it decides to terminate, to file for a determination letter on termination without having to rerun all of its coverage and nondiscrimination testing since inception considering only its own employees. There is no comparable provision, however, for a PEO that chooses to change to a Multiple Employer Retirement Plan.

A PEO can take advantage of this Revenue Procedure, even though it is currently under audit.

If a PEO wishes to comply with Revenue Procedure 2002-21, then on or before the PEO Decision Date (May 2, 2003 for a calendar year plan), the PEO must do all of the following:

Decide either to sponsor a Multiple Employer Retirement Plan or to terminate its existing PEO Retirement Plan.

If it decides to terminate, the PEO must adopt a resolution to that effect by the PEO Decision Date. For a corporation, this is done by board resolution. In a partnership, it is done by a vote of the partners. For other entities, a "comparable binding action" is required. The resolution must specify that the plan is to be terminated on or before the Compliance Date.

If it decides to convert to a Multiple Employer Retirement Plan, then it must adopt the necessary amendments by the PEO Decision Date. The amendments must be effective no later than the first day of the first plan year beginning after 2003.

Notify all COs with Worksite Employees participating in the existing plan of its choice. The notice must be postmarked by the PEO Decision Date if it is mailed.[3] The notice must inform COs of their options with regard to the PEO's decisions and must establish deadlines for the COs to comply themselves.

Once the CO receives the notice from the PEO, it has the following choices:

They can have assets for their Worksite Employees spun off to a new terminating plan, the Spin-off Retirement Plan. This plan must be terminated on or before the Compliance Date. The assets of this plan will be distributed to employees as soon as possible after termination. This is the default option. If the CO does not specify another choice, or comply with the requirement of another choice they have selected, then this is what will happen.

They can have the PEO Retirement Plan transfer to the CO's defined contribution plan (including a 401(a) plan or 403(a) plan) all of the assets and liabilities relating to their Worksite Employees. To select this option, the CO must notify PEO that it is making this choice and provide the PEO with documentation showing that its plan either has a favorable determination, notification, or opinion letter under GUST, or else has applied for a GUST determination letter. The PEO's will specify the dates by which the CO must notify the PEO and provide the documentation. (Those can be two different dates.) Practically speaking, both dates must be soon enough before the end of the 2003 plan year to allow the PEO to transfer the assets to the CO plan by the Compliance Date if they comply, or to transfer the assets to the terminating spin-off plan if the CO does not comply.

Finally, if the PEO sets up a Multiple Employer Retirement Plan, the CO can choose to cosponsor that plan. Again, the CO must notify the PEO that it will take this choice by a date specified in the PEO's notice. The CO must actually adopt the plan by a deadline set by the PEO in its notice, and in any event before the end of the 2003 plan year (the Compliance Date). If the CO does not sign on by the PEO's deadline, then their employees' assets go to the terminating spin-off plan.

[3] Opinion of S. Derrin Watson, J.D. - "Who's The Employer" - A Guide to Employee and Aggregation Issues Affecting Qualified Plans.

The Spin-off Retirement Plan is a new plan set up by the PEO to handle the funds of the Worksite Employees whose COs have chosen that option, whether through action or inaction. Assets and liabilities of those employees must be transferred to the new plan by the Compliance Date. The spin-off plan must also be terminated by the Compliance Date. (No, the IRS will not raise the "permanence" issue for this plan.) The spin-off plan must distribute the assets to the employees as soon as administratively feasible after termination. The spin-off must comply with IRC 414(l). There only needs to be one spin-off plan for all COs who have chosen this option.

If the PEO sets up a Multiple Employer Retirement Plan, it is required to request a determination letter on that plan. For purposes of the remedial amendment period, the requirement that the PEO adopt such a plan is treated as a disqualifying provision. In such a plan, the 2004 determination date for top-heavy purposes under IRC 416 is the last day of the plan year as a Multiple Employer Retirement Plan. After the Compliance date, Worksite Employees performing services for COs who do not adopt the plan cannot make contributions to, or otherwise participate in the Multiple Employer Plan, even if they are, in fact, common law employees of the PEO.

If the PEO chooses the termination option, then by the Compliance Date the original PEO retirement plan will be terminated and essentially all of its assets distributed, either to CO plans or to the spin-off plan. The PEO must seek a determination letter on termination of the PEO Retirement Plan as well as a letter on the termination of the Spin-off Retirement Plan.

Any notice sent under the Revenue Procedure can be sent electronically or by any other method "that reasonably ensures that the intended recipient will receive timely and adequate notice." This includes both the PEO's notice and the CO's response.

If there are any qualification problems, other than the issues for which the Revenue Procedure grants relief (essentially the exclusive benefit rule), then those can be resolved normally through the Employee Plans Compliance Resolution System (EPCRS). It can be sent electronically or by any other method "that reasonably ensures that the intended recipient will receive timely and adequate notice."

NON COMPLIANCE – REVENUE PROCEDURE 2002-21

According to Revenue Procedure 2002-21, the following consequences will be faced by a PEO sponsoring a single employer PEO Retirement Plan that falls in any of these three categories:

1) The PEO chooses not to comply with Revenue Procedure 2002-21;

2) The PEO does not timely comply with all its requirements; or

3) The PEO adopts a single employer plan after the Effective Date (May 13, 2002) and hence is not eligible to comply.

The PEO will not be able to rely on the relief promised in the Revenue Procedure. Therefore, the PEO is at risk for disqualification under the exclusive benefit rule.

Participants receiving distributions who choose to roll over those distributions are at risk for the IRS finding that the rollovers were improper. Accordingly, the participants would be taxable and would be subject to a penalty tax on excess IRA contributions.

The PEO would need to rerun any nondiscrimination, ADP and coverage tests based only on its employees

If there is still a single employer PEO Retirement Plan covering Worksite Employees, then effective as of the first plan year beginning after 2003, it will not be able to rely on any determination letter, regardless of the date of the letter.

How does a PEO set up a multiple employer plan? [4]

Under Revenue Procedure 2002-21, before the PEO Decision Date, it must adopt a resolution choosing to go with a multiple employer plan, amend its existing single employer PEO plan into a multiple employer plan, and notify its COs of its decision. The amendment should provide that only Worksite Employees of COs who adopt the plan, and employees of the PEO who are not Worksite Employees (i.e., back office employees of the PEO) may participate. The amendment should be effective no later than the first day of the plan year beginning in 2004.

How does a CO adopt a PEO multiple employer plan?

Once it receives the PEO's notice that it is setting up a multiple employer plan under Revenue Procedure 2002-21, the CO must notify the PEO that it intends to adopt the plan, and it must actually sign on to the amendment. Each must be done by the deadlines set in the PEO's notice.

Is a CO with an existing retirement plan prevented from becoming an adopting employer of a PEO's multiple employer plan?

No. A company could have many retirement plans satisfying different objectives. Such plans must be aggregated for a variety of purposes, but that does not prevent a CO from using a PEO's plan to cover some of its workers.

How is employee status affected by a multiple employer plan?

The adoption of a multiple employer plan does not change or otherwise affect who is an employee's employer under common law principles. However, there are specific plan rules, such as the exclusive benefit rule, which are applied as though each employer maintaining the plan was the employer of the employee.

For example, suppose that a given Worksite Employee is actually the common law employee of the PEO and not the CO. A temp worker, who only works one week at any given job site might well meet this definition. Such a worker is an employee of the PEO for purposes of coverage testing, whether or not the CO adopts the plan.

How does a multiple employer plan comply with the exclusive benefit rule?

IRC 413(c)(3) says that in a multiple employer plan, "For purposes of section 401(a), in determining whether the plan of an employer is for the exclusive benefit of his employees and their beneficiaries, all plan participants shall be considered to be his employees."

Notice that it does not say that all such employees are deemed to be employed by a single employer. Rather, it says that each employer adopting the plan is deemed to be the employer of all employees in the plan for purposes of the exclusive benefit rule.

[4] These questions and answers were formed by S. Derrin Watson, J.D. in his book, "Who's The Employer" - A Guide to Employee and Aggregation Issues Affecting Qualified Plans.

Because of this provision, conservative PEO's have long used multiple employer plans to insulate their plans from a challenge on the basis of the exclusive benefit rule. Either the PEO is the employer or the CO is the employer of a given Worksite Employee. So long as one of them is the employer, and each of them adopts the plan, the exclusive benefit rule is satisfied.

How is service counted in a multiple employer plan for participation and vesting?

IRC 413(c)(1) says that in a multiple employer plan, "Section 410(a) shall be applied as if all employees of each of the employers who maintain the plan were employed by a single employer."

IRC 413(c)(3) says that in a multiple employer plan, "Section 411 shall be applied as if all employers who maintain the plan constituted a single employer, except that the application of any rules with respect to breaks in service shall be made under regulations prescribed by the Secretary of Labor."

These rules mean that for purposes of counting hours of service and years of service for participation, vesting, and benefit accrual are applied as though all adopting employers were a single employer. As Revenue Procedure 2002-21 puts it, "an employee's service with all of the employers participating in the plan is taken into account for purposes of vesting under § 411 and plan participation under § 410(a)."

For example, consider John who was an employee of Company X, a PEO client who has adopted the PEO's multiple employer plan, from 2004 to 2007. During that period he accrued four years of service for vesting purposes. John then leaves Company X and starts to work for Company Y, another adopting employer of the PEO's plan. John immediately starts his involvement in the Company Y plan with four years of service for vesting purposes.

How is coverage testing run in a multiple employer plan?

Notwithstanding that hours of service with any participating employer are counted together for purposes of 410(a), each employer separately determines whether it complies with 410(b). Thus, as IRC 1.413-2(a)(3)(ii) says: "the minimum coverage requirements of section 410(b) are generally applied to a section 413(c) plan on an employer-by-employer basis, taking into account the generally applicable rules such as section 401(a)(5) and section 414 (b) and (c)."

So, suppose that ABC Company is a CO adopting its PEO's multiple employer plan. For purposes of calculating the ratio percentage test under 410(b), only employees of ABC are counted. The same is true of each other employer adopting the plan (including the PEO itself). If any participating employer fails to satisfy 410(b), then the plan as a whole does not satisfy that section and is subject to disqualification.

How is ADP and other nondiscrimination testing run in a multiple employer plan? [5]

Each participating employer must separately satisfy the ADP test, the ACP test, and the applicable nondiscrimination requirements of 401(a)(4) with regard to its own employees. See 1.413(c)-2(a)(3)(iii).

[5] These questions and answers were formed by S. Derrin Watson, J.D. in his book, "Who's The Employer" - A Guide to Employee and Aggregation Issues Affecting Qualified Plans.

How are the top-heavy rules applied to a multiple employer plan?

Reg 1.416-1 Q&A G-2 explains the issue very well: "G-2 Q. Is a multiple employer plan subject to the top-heavy requirements of section 416? A. A multiple employer plan is subject to the requirements of section 416, but only with respect to each individual employer. Thus, if twelve employers contribute to a multiple employer plan and the accrued benefits for the key employees of one employer exceed 60 percent of the accrued benefits of all employees for such employer, the plan is top-heavy with respect to that employer. A failure by the multiple employer plan to satisfy section 416 with respect to the employees of such employer means that all employers are maintaining a plan that is not a qualified plan."

Thus each adopting employer separately determines whether its portion of the plan is top heavy. In doing so, key employee status is determined separately for each adopting employer. If an employer's portion of the plan is top heavy, then that employer must apply the appropriate vesting schedule and provide the required minimum contributions or benefits. If the employer fails to do so, then the plan as a whole is disqualified for all adopting employers.

How are the 415 limits applied to a multiple employer plan?

Reg. 1.415(e)-1 says that in a multiple employer plan, "For purposes of applying the limitations of section 415 with respect to a participant of an employer maintaining the plan, benefits or contributions attributable to such participant from all of the employers maintaining the plan must be taken into account. Furthermore, in applying the limitations of section 415 with respect to such a participant, the total compensation received by the participant from all of the employers maintaining the plan may be taken into account." Thus, a participating employee has one 415 limit for all adopting employers. The 415-compensation limit is based on total compensation from all adopting employers.

How are deduction limits determined for a multiple employer plan?

If the plan was adopted before 1989, there is a single deduction limit shared by all adopting employers unless the employers had elected to determine the limits separately. If the plan was adopted after 1988, each employer has its own deduction limit based on the compensation of its participating employees. See IRC 413(c)(6).

How is HCE status determined in a multiple employer plan? [6]

Each adopting employer with respect to its own employees determines an HCE separately. This makes sense because nondiscrimination and coverage testing are performed on an employer-by-employer basis.

What are the filing requirements of a multiple employer plan?

A single 5500 form is filed for the entire plan. However, a separate Schedule T is filed for each adopting employer, since each performs coverage testing separately.

[6] These questions and answers were formed by S. Derrin Watson, J.D. in his book, "Who's The Employer" - A Guide to Employee and Aggregation Issues Affecting Qualified Plans.

What happens if there is an operational failure affecting one portion of a multiple employer plan?

1.413-2(a)(4)(iv) says "The qualification of a section 413(c) plan, at any relevant time, under section 401(a), 403(a) or 405(a), as modified by section 413(c) and this section, is determined with respect to all employers maintaining the section 413(c) plan. Consequently, the failure by one employer maintaining the plan (or by the plan itself) to satisfy an applicable qualification requirement will result in the disqualification of the section 413(c) plan for all employers maintaining the plan."

So there is nothing that immunizes one participating employer from mistakes committed by another. Put another way, if any part of a multiple employer plan is disqualified, the whole plan is disqualified.

Of course, in the modern age of EPCRS, relatively few plans are disqualified. The focus is on fixing the problems. It would make sense in a multiple employer plan to require contractually that each employer be responsible for fixing mistakes relating to its portion of the plan.

How does a new CO join an existing multiple employer PEO plan?

It must adopt to the plan and comply with any appropriate procedures established by the PEO.

In the process, the CO could, assuming the PEO plan permitted it, terminate the CO's existing plan and transfer the assets and liabilities of that CO plan to the PEO plan.

Alternatively, the CO could choose to retain its existing plan. In that case, it could freeze future benefit accruals, or allow its plan to supplement the benefits provided under the PEO plan.

How does a CO leave a multiple employer PEO plan?

It must terminate its sponsorship of the plan, signing the appropriate paperwork.

After termination, it should probably arrange for a spin-off of the assets and liabilities of its employees to a plan established by the CO (or which it cosponsors with its new PEO). Such a spin-off will need to comply with IRC 414(l).

Alternatively, after termination it can arrange for distribution of assets to its employees and their beneficiaries, in accordance with the terms of the plan.

What are the advantages to a CO of adopting a multiple employer plan? [7]

The chief advantages are savings in administrative costs and burdens. The PEO handles the administration, just as it handles payroll tax returns, and the CO does not need to be bothered with it. Since the plan files a single 5500, costs of preparing that 5500, as well as costs of preparing plan updates to deal with changes in the law, can be spread over all adopting employers. This is a major savings.

[7] These questions and answers were formed by S. Derrin Watson, J.D. in his book, "Who's The Employer" - A Guide to Employee and Aggregation Issues Affecting Qualified Plans.

What are the disadvantages to a CO of adopting a multiple employer plan? Are there several potential disadvantages?

The CO must count service performed for other adopting employers.

The plan can be disqualified if any employer's portion is handled improperly. One bad apple spoils the whole barrel.

The CO will likely have less flexibility in choosing plan design options than it would if it adopted its own plan.

The CO's employees are at risk for the dishonesty or ineptitude of PEO administrators and trustees. However, a CO should already have considered this issue when hiring the PEO. After all a dishonest PEO can simply take payroll money and leave the country, or not pay payroll taxes, which are potentially worse fates for the CO. PEO's must be carefully selected. As for ineptitude, the CO must balance the potential ineptitude of the PEO with its own experience or lack of experience in investing. Oftentimes the scales will tip in favor of the PEO.

What happens if the PEO sponsoring a multiple employer plan goes out of business?

In most likelihood, the other employers terminate the plan and spin off the assets relating to their employees to their own plans or to the plan of a new PEO.

These frequently asked questions and answers are provided for general information only and should not be cited as any type of legal authority.[8] They are designed to provide the user with information required to respond to general inquiries. Due to the uniqueness and complexities of Federal tax law, it is imperative to ensure a full understanding of the specific question presented, and to perform the requisite research to ensure a correct response is provided.

Per the changes made to the determination letter program for Multiple Employer Plans by Announcement 2001-77, does each adopting employer have to come in for an individual determination letter?

Under the old procedures, each employer maintaining the plan had to submit a Form 5300 application. Under the new procedures, the sponsors of the plan have two choices:

Submit just for a determination letter on the plan; or

Submit for determination letter on the plan and a letter for each employer maintaining the plan who wants an individual letter. Note: All adopting employers do NOT have to submit for a determination letter.

Are the adopting employers required to give Notice to Interested Parties if they are not coming in for individual letters?

Yes, this law does not change the "Notice to Interested Parties" requirement.

Do the employers maintaining the plan have reliance on the determination letter issues to the plan?

Yes. Announcement 2001-77 states, "The employers will be able to rely on the favorable determination letter issued for the plan except with respect to the requirements of 401(a)(4), 401(a)(26), 401(l), 410(b) and 414(s) and, if the employer maintains or has ever maintained another plan, IRC 415 and 416".

It is important to remember that this modification of reliance procedures is subject to other limitations and conditions described in Section III of the announcement.

Call The Pension Specialists at EBP - 1-800-622-2411

http://www.benefitplans.com

info@benefitplans.com

[8] Extracted from the IRS website at http://www.irs.gov/retirement/article/0,,id=97175,00.html

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PART III. ADMINISTRATIVE, PROCEDURAL, AND MISCELLANEOUS

26 CFR 601.201: Rulings and determination letters

(Also, Part I, § 401; § 1.401(a)-2.)

Rev. Proc. 2002-21

SECTION 1. INTRODUCTION

.01 *Introduction.* This revenue procedure describes steps that may be taken to ensure the qualified status of defined contribution retirement plans maintained by professional employer organizations (PEOs) for the benefit of Worksite Employees. PEOs are also commonly known as employee leasing organizations.

.02 *Potential for plan disqualification.* The employment relationship between workers and the employer maintaining a plan is fundamental to whether a plan is qualified under § 401(a) of the Internal Revenue Code. The determination of whether an employment relationship exists depends on the facts and circumstances of each particular case. If a retirement plan provides benefits for individuals who are not employees of the employer maintaining the plan, the plan does not satisfy the exclusive benefit rule contained in § 401(a)(2), and therefore could be disqualified.

03. *Relief from disqualification of plan.* The Service recognizes the complexity involved in the determination of whether a Worksite Employee is the common law employee of the PEO or the client organization (CO), as well as the need of the PEO, the CO, Worksite Employees, and plan administrators for certainty in this area. Accordingly, this revenue procedure provides a framework under which plans sponsored by PEOs will not be treated as violating the exclusive benefit rule solely because they provide benefits to Worksite Employees. Under the approach provided in this revenue procedure, a PEO that maintains a defined contribution retirement plan may establish a multiple employer plan that benefits Worksite Employees providing services to COs. For PEOs that do not wish to establish a multiple employer plan, the revenue procedure provides transition rules under which the existing PEO plan will be treated as a qualified plan if it is terminated by a specified date.

SECTION 2. PURPOSE

.01 *In general.* The purpose of this revenue procedure is to provide relief with respect to certain defined contribution retirement plans maintained by a PEO ("PEO Retirement Plans") that benefit Worksite Employees.

.02 *Scope of relief.* With regard to PEO Retirement Plans established prior to May 13, 2002, if the requirements of section 5 are met, the Service will not disqualify the PEO Retirement Plan solely on account of an exclusive benefit rule violation under § 401(a)(2) for a plan year beginning before the Compliance Date if that violation results from the PEO Retirement Plan benefiting Worksite Employees who are not the PEO's employees. Relief provided under this revenue procedure applies

only with respect to the PEO Retirement Plan for which relief is granted and not to other plans maintained by a CO or the PEO.

.03 *No effect on other law*. The relief provided under this revenue procedure with respect to the provisions of § 401(a) has no effect on the rights of any party under any other law, including Title I of the Employee Retirement Income Security Act of 1974 and other provisions of the Internal Revenue Code.

SECTION 3. BACKGROUND

.01 *In general*. An employee leasing arrangement typically involves the interaction among three parties: the PEO, the CO, and the Worksite Employees. In a typical situation, a PEO enters into an agreement with a CO whereby employees become Worksite Employees and continue to provide services to the CO.

.02 *Employment relationship*. The issue of whether a worker is an employee of a particular entity for employment tax purposes is determined by reference to § 3121(d), which incorporates the common law definition of employee. The Supreme Court has also applied this common law definition of employee for purposes of determining whether a worker is an employee entitled to receive benefits under a retirement plan. See Nationwide Mutual Insurance Co. v. Darden, 503 U.S. 318 (1992). Courts have also found that common law factors are applicable to determine which of two entities is the employer for purposes of retirement plans. The critical issue in determining who is the employer of an individual is which entity has the right to direct and control the individual performing the services. If it is found that the CO, not the PEO, is the employer, the plan maintained by a PEO that benefits Worksite Employees of the CO would fail to satisfy the exclusive benefit rule. See Professional and Executive Leasing, Inc. v. Commissioner, 89 T.C. 225 (1987), aff'd, 862 F.2d 751 (9th Cir. 1988).

.03 *Exclusive benefit rule*. Section 401(a)(2) provides that a trust forming a part of a qualified pension, profit-sharing, or stock bonus plan must be a trust established and maintained by an employer for the exclusive benefit of that employer's employees and their beneficiaries ("exclusive benefit rule"). Therefore, a retirement plan that provides benefits for individuals who are not employees of the employer maintaining the plan (and who are not otherwise treated as employees under rules such as those under § 414) violates the exclusive benefit rule and does not satisfy the requirements of § 401(a).

.04 *Leased employees*. Section 414(n) does not permit PEOs to maintain plans for Worksite Employees who are not the common law employees of the PEO. Section 414(n) deals with individuals who are not common law employees of the entity for which they perform services ("recipient") but who might have to be taken into account in determining whether a retirement plan maintained by the recipient satisfies the requirements of § 401(a). Notice 84-11, 1984-2 C.B. 469, provides questions and answers relating to § 414(n). Section 414(n) addresses the relationship between the recipient and the leased workers, but it does not apply to situations in which a worker is the common law employee of the recipient.

.05 *Multiple employer plan*. Section 413(c) provides rules for the qualification of a plan maintained by more than one employer (i.e., a "multiple employer plan"). Under § 413(c)(2), in determining whether a multiple employer plan complies with the exclusive benefit rule, all employees benefiting under the multiple employer plan are treated as the employees of all employers who maintain the plan. Additionally, an employee's service with all of the employers participating in the plan is taken into account for purposes of vesting under § 411 and plan participation under § 410(a). See §

413(c)(1) and (3). Similarly, for purposes of the contribution and benefit limitations of § 415, an employee's compensation from all employers participating in the plan is taken into account. See § 1.415-1(e)(1) of the Income Tax Regulations. Other rules apply separately to each participating employer and its employees. For example, nondiscrimination testing under § 401(a)(4) and § 401(k), and coverage testing under § 410(b), are performed separately for each employer maintaining the multiple employer plan. See § 1.401(a)(4)-1(c)(4), § 1.413-2(a)(3)(ii) and § 1.401(k)-1(g)(11). Top-heavy requirements under § 416 also apply separately to each employer. See § 1.416-1, Q&A G-2.

SECTION 4. RELIEF AVAILABLE

.01 *No disqualification of PEO Retirement Plan.* If a PEO has a PEO Retirement Plan in existence on May 13, 2002, that benefits Worksite Employees, section 5 provides the PEO with the option of either converting the PEO Retirement Plan to a multiple employer plan or terminating the plan. If a PEO timely satisfies the requirements of section 5, the Service will not disqualify its PEO Retirement Plan solely on the grounds that the plan violates or has violated the exclusive benefit rule for plan years beginning before the Compliance Date by benefitting Worksite Employees who are not the PEO's employees.

.02 *Effective Dates.* (1) Compliance Date. Except as specifically provided, all remedial actions and other requirements in section 5 must be completed by the Compliance Date. The Compliance Date is the last day of the first plan year of the PEO Retirement Plan beginning on or after January 1, 2003. For a calendar year plan, the Compliance Date is December 31, 2003. (2) PEO Decision Date. The PEO Decision Date is the date by which the PEO must take specified actions affirming its decision whether to terminate the PEO Retirement Plan or maintain a multiple employer retirement plan that benefits Worksite Employees. The PEO Decision Date is the date that is 120 days after the first day of the plan year beginning on or after January 1, 2003. For a calendar year plan, the PEO Decision Date is May 2, 2003.

.03 *Plan terminations.* For the purpose of determining whether a PEO Retirement Plan or Spinoff Retirement Plan satisfies the qualification requirements in § 401(a) upon plan termination (as described in section 5.06), Worksite Employees may be treated as if they were employees of the PEO.

SECTION 5. REMEDIAL ACTION REQUIRED

.01 *In general.* In order to obtain the relief provided in section 4, the plan sponsor of a PEO Retirement Plan must either terminate the PEO Retirement Plan in accordance with section 5.02, or convert the PEO Retirement Plan into a multiple employer plan ("Multiple Employer Retirement Plan") in accordance with section 5.03.

.02 *Termination Option.* (1) Termination of PEO Retirement Plan. If a PEO chooses to terminate a PEO Retirement Plan in accordance with this section, the PEO must adopt a resolution of its board of directors (or, if the PEO is not a corporation, it must take comparable binding action, such as a partnership vote) on or before the PEO Decision Date, providing that the plan will be terminated on or before the Compliance Date. After the date of termination, all assets in the plan's related trust must be distributed as soon as administratively feasible. See Rev. Rul. 89-87, 1989-2 C.B. 81. Consequently, the mere discontinuance of contributions under the PEO Retirement Plan is not a termination of the plan and will not satisfy the requirements of this section.

(2) Notification of COs. The PEO must provide notice of the options set forth in section 5.02(3) to each CO that has Worksite Employees with accrued benefits in the PEO Retirement Plan. The

PEO must specify in the notice the date by which each CO must notify the PEO of the option it selects. This notice must be sent on or before the PEO Decision Date.

(3) CO Options. The PEO must provide each CO with all of the following options:

(a) Transfer of assets and liabilities to CO plans. The CO may choose to have the assets and liabilities of the PEO Plan that are attributable to Worksite Employees performing services for the CO transferred to a retirement plan of the CO as provided in section 5.04(1). The transfer of assets and liabilities attributable to Worksite Employees performing services for the CO to the CO's plan must be completed on or before the Compliance Date.

(b) Spinoff of assets and liabilities to a separate plan and termination of that plan. The CO may choose to have the assets and liabilities of the PEO Retirement Plan that are attributable to its Worksite Employees spun off to a Spinoff Retirement Plan, which is then terminated, as provided in section 5.04(2). The spinoff and termination must be completed on or before the Compliance Date. Plan assets must be distributed as soon as administratively feasible after the plan termination date.

(4) CO Decision and Implementation. The CO must provide notice of the selected option to the PEO by a date specified by the PEO. If a CO fails to timely inform the PEO of the option it selected, the PEO must treat the CO as having selected option 5.02(3)(b) (Spinoff and Termination). The PEO must implement the choice made or deemed made by each CO on or before the Compliance Date.

(5) Determination Letter request. The PEO must request determination letters on the termination of the PEO Retirement Plan and the Spinoff Retirement Plan. See section 5.06 of this revenue procedure for further information on determination letters on plan terminations.

.03 *Conversion Option.* (1) Conversion to Multiple Employer Retirement Plan. A PEO may choose to convert the PEO Retirement Plan to a Multiple Employer Retirement Plan, effective the first day of the first plan year beginning after the Compliance Date. If the PEO chooses this option, the PEO must satisfy the requirements of section 5.03(2) through (6). In addition, the Multiple Employer Retirement Plan must be adopted by those COs that wish to have Worksite Employees participate in the plan. To the extent that a PEO Retirement Plan is converted into a Multiple Employer Retirement Plan, assets and liabilities will remain in the plan and not be distributed to participants.

(2) Adoption of Plan Amendments. The PEO must adopt plan amendments necessary to convert the PEO Retirement Plan to a Multiple Employer Retirement Plan on or before the PEO Decision Date. The effective date of the plan amendments adopted by the PEO must be no later than the first day of the first plan year beginning after the Compliance Date.

(3) Notification of COs. The PEO must provide notice of the options set forth in section 5.03(4) to each CO that has Worksite Employees with accrued benefits in the PEO Retirement Plan. The PEO must specify in the notice the date by which each CO must notify the PEO of the option it selects. This notice must be sent on or before the PEO Decision Date.

(4) CO Options. The PEO must provide each CO with all of the following options:

(a) Adoption of Multiple Employer Retirement Plan. The CO may adopt the Multiple Employer Retirement Plan. The CO must adopt the Multiple Employer Retirement Plan by the first day of the first plan year beginning after the Compliance Date (or any earlier date as may be specified by the PEO). If a CO chooses this option, the Worksite Employees performing services for the CO may

participate in the Multiple Employer Retirement Plan after its adoption by the CO without causing the plan to fail to satisfy the exclusive benefit rule. If a CO has not adopted the Multiple Employer Retirement Plan by the first day of the first plan year beginning after the Compliance Date (or any earlier date as may be specified by the PEO), the Multiple Employer Retirement Plan may not accept contributions after the Compliance Date on behalf of the Worksite Employees performing services for the CO. In that event, the assets and liabilities attributable to the COs must be spun off as soon as administratively feasible to a Spinoff Retirement Plan.

(b) Transfer of assets and liabilities to CO plans. The CO may choose to have the assets and liabilities of the PEO Retirement Plan that are attributable to its Worksite Employees transferred to a retirement plan of the CO as provided in section 5.04(1). The transfer must be completed on or before the Compliance Date.

(c) Spinoff of assets and liabilities to a separate plan and termination of that plan. The CO may choose to have the assets and liabilities of the PEO Retirement Plan that are attributable to its Worksite Employees spun off to a Spinoff Retirement Plan that is then terminated, as provided for in section 5.04(2). The spinoff and termination must occur on or before the Compliance Date. Plan assets must be distributed as soon as administratively feasible after the plan termination date

(5) CO Decision and Implementation. The CO must provide notice of the selected option to the PEO by a date specified by the PEO. If a CO fails to timely inform the PEO of the option it selected, the PEO must treat the CO as having selected option 5.03(4)(c) (Spinoff of assets and liabilities). The PEO must implement the choice made or deemed made by each CO on or before the Compliance Date.

(6) Determination Letter request. The PEO must request determination letters on the Multiple Employer Retirement Plan and the Spinoff Retirement Plan. See section 7.02 of this revenue procedure for further information on an application for a determination letter on the qualified status of a Multiple Employer Retirement Plan. See section 5.06 of this revenue procedure for further information on determination letters on plan terminations.

.04 *Transfers to CO's plan or Spinoff of CO's assets and liabilities.* This section 5.04 applies if the PEO decides to terminate the PEO Retirement Plan; if a CO chooses to terminate its participation in the PEO Retirement Plan and transfer its attributable assets and liabilities to the CO's plan; or if a CO's attributable assets and liabilities are spun off to a Spinoff Retirement Plan and distributed in connection with the termination of the Spinoff Retirement Plan.

(1) Transfers to CO's plan. (a) Documentation of qualified status of plan maintained by the CO. If a CO chooses to transfer its attributable assets and liabilities in a PEO's Retirement Plan to the CO's plan, the CO must provide the PEO, on or before a date specified by the PEO, with documentation that the plan to which assets are transferred is a qualified plan established and maintained by the CO. If such documentation is provided, the PEO must transfer the assets and liabilities attributable to the Worksite Employees from the PEO Retirement Plan to the CO's plan before the Compliance Date. If the CO fails to provide the PEO with this documentation, or any other information required by the PEO to effect transfer, on or before the date specified by the PEO, the PEO must utilize the procedures in section 5.04(2).

(b) Qualified Plan Determination. For purposes of determining whether a CO maintains a qualified plan, a "qualified plan" is a retirement plan that on or before the Compliance Date either (i) had received a favorable determination, notification, or opinion letter that considered GUST (GUST is an acronym for the Uruguay Round Agreements Act (GATT), the Uniformed Services

Employment and Reemployment Rights Act of 1994 (USERRA), the Small Business Job Protection Act of 1996 (SBJPA), the Taxpayer Relief Act of 1997 (TRA'97), the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA'98) and the Community Renewal Tax Relief Act of 2000) or (ii) had submitted a request to the Service for a determination letter that considers GUST.

(2) Spinoff and termination. If a CO chooses a spinoff, or fails to timely notify the PEO of its selection, the PEO must implement a spinoff of the assets and liabilities of the PEO's Retirement Plan that are attributable to the CO's Worksite Employees to a Spinoff Retirement Plan. The Spinoff Retirement Plan may receive and hold assets and liabilities attributable to Worksite Employees of all of the COs that selected the spinoff option or failed to timely notify the PEO of a selection. The PEO must then terminate the Spinoff Retirement Plan on or before the Compliance Date and distribute benefits to the Worksite Employees performing services for the COs as soon as administratively feasible after the termination date. For purposes of this revenue procedure, a spinoff means a spinoff of plan assets and liabilities attributable to the Worksite Employees performing services for the COs selecting the spinoff option (or failing to timely select an option) from the PEO Retirement Plan to a Spinoff Retirement Plan that satisfies the transfer requirements of § 414(l).

.05 *Methods of providing notice.* Any notice required to be provided under this revenue procedure may be sent by any method, including an electronic medium, that reasonably ensures that the intended recipient will receive timely and adequate notice. For purposes of this revenue procedure, notice sent by United States mail is considered sent as of the date of the United States postmark stamped on the cover in which the notice is mailed.

.06 *Plan terminations.* (1) Request for determination letter on plan termination. In choosing any of the options relating to plan terminations, a PEO must request a determination letter on the plan termination. Section 12 of Rev. Proc. 2002-6, 2002-1 I.R.B. 203, explains the procedures for requesting determination letters involving qualification of a plan upon plan termination. The permanency requirement described in § 1.401-1(b)(2) will not be raised as a disqualifying defect for plans being terminated pursuant to this revenue procedure. The request for a determination letter must be made within one year of the date of termination using the applicable provisions of Rev. Proc. 2002-6.

(2) Distribution treated as being from a qualified plan. Distributions made to Worksite Employees upon the termination of the PEO Retirement Plan or Spinoff Retirement Plan in accordance with this section will not fail to be eligible for favorable tax treatment accorded distributions from qualified plans (including eligibility for tax-free rollovers) solely because the plan violated the exclusive benefit rule of § 401(a)(2).

.07 *Example.* (i) A PEO maintains a PEO Retirement Plan established in 1994, and the PEO uses the calendar year for its plan year. The PEO Retirement Plan treats all Worksite Employees performing services for COs as employees of the PEO. There are 75 COs with Worksite Employees benefiting under the PEO Retirement Plan.

(ii) After reviewing the options set forth in section 5, the PEO decides to convert the PEO Retirement Plan to a Multiple Employer Retirement Plan. In accordance with the requirements of section 5.03, on January 31, 2003, the PEO adopts amendments to the PEO Retirement Plan converting the plan to a Multiple Employer Retirement Plan, effective January 1, 2004. On February 14, 2003, the PEO mails notification to each CO that it has decided to convert the PEO Retirement Plan to a Multiple Employer Retirement Plan and explains the options available to the CO as described in section 5.03(4). In its letter to the COs, the PEO explains that each CO has until August 15, 2003, to notify the PEO, in writing, of its choice. The letter explains that if the CO does not

notify the PEO of its selected option on or before August 15, 2003, the PEO will treat the CO as having selected the spinoff and termination option. The letter further explains that if a CO elects to adopt the Multiple Employer Retirement Plan, the Plan must be adopted on or before December 1, 2003.

(iii) By August 15, 2003, fifty of the COs with Worksite Employees benefiting under the PEO Retirement Plan notify the PEO of their decision to adopt and maintain the Multiple Employer Retirement Plan for the Worksite Employees. By December 1, 2003, forty-nine of the fifty COs adopted the Multiple Employer Retirement Plan, effective January 1, 2004. In accordance with section 5.03(4)(a) of this revenue procedure, on December 10, 2003, the PEO spins off the assets and liabilities attributable to the one CO that did not timely adopt the Multiple Employer Retirement Plan to a Spinoff Retirement Plan.

(iv) Ten COs timely elect a transfer, in which the assets and liabilities attributable to each CO's Worksite Employees are transferred to a qualified retirement plan established and maintained by each CO, and that satisfy the requirements described in section 5.04(1). The ten COs timely provide all information required to effect the transfer, including documentation of the plans' qualified status. The transfers to each of the CO plans are completed by December 31, 2003.

(v) Ten COs affirmatively elect the spinoff and termination option. The PEO spins off plan assets and liabilities attributable to the Worksite Employees performing services for those COs to the Spinoff Retirement Plan on December 10, 2003.

(vi) The remaining five COs failed to notify the PEO of their choice by August 15, 2003. Therefore, in accordance with requirements in section 5.03(5), each of those COs is treated as having selected the spinoff and termination option as its choice. The PEO spins off the assets and liabilities of these COs to the Spinoff Retirement Plan on December 10, 2003.

(vii) On December 11, 2003, the PEO terminates the Spinoff Retirement Plan. On February 5, 2004, the PEO submits an application for a determination letter on the termination of the Spinoff Retirement Plan. The PEO receives a favorable determination letter on the termination of the plan. As soon as administratively feasible following the termination, distributions are made to the Worksite Employees performing services for the sixteen COs (the one CO that failed to timely adopt the Multiple Employer Retirement Plan, the ten COs that selected the spinoff and termination option, and the five COs that failed to timely notify the PEO of their choice) with assets in the Spinoff Retirement Plan.

(viii) On February 5, 2004, the PEO submits an application for a determination letter on the qualified status of the Multiple Employer Retirement Plan, and subsequently receives such a determination letter from the Service. Because the PEO took all of the steps required in section 5 of the revenue procedure, the PEO Retirement Plan is entitled to the relief set forth in section 4 of the revenue procedure.

.08 *PEOs not electing to take advantage of relief under this revenue procedure.* If a PEO does not, as of the Compliance Date, either terminate the PEO Retirement Plan it maintains for Worksite Employees performing services for COs (as provided for in section 5.02) or convert the PEO Retirement Plan to a Multiple Employer Retirement Plan (as provided for in section 5.03), the relief in this revenue procedure is not available for any violations of the qualification requirements, including violations of the exclusive benefit rule, by PEO Retirement Plan.

.09 *No Reliance on Determination Letters for PEO Retirement Plans.* After the Compliance Date, a PEO may not rely on a determination letter for a PEO Retirement Plan that benefits Worksite Employees performing services for COs, regardless of when the determination letter was issued.

SECTION 6. DEFINITIONS

.01 *PEO Retirement Plan.* The term "PEO Retirement Plan" means a defined contribution plan (including a plan that includes a cash or deferred arrangement described in § 401(k)) intended to satisfy the requirements of § 401(a) or § 403(a). The definition of a PEO Retirement Plan does not include a plan maintained as a multiple employer plan that has been adopted by a PEO and one or more COs.

.02 *Multiple Employer Retirement Plan.* The term "Multiple Employer Retirement Plan" means a defined contribution plan (including a plan that includes a cash or deferred arrangement described in § 401(k)) intended to satisfy the requirements of § 401(a) or § 403(a), and § 413(c), under which each CO is treated as an employer.

.03 *Spinoff Retirement Plan.* The term "Spinoff Retirement Plan" means a separate plan established by a PEO for the specific purpose of a spinoff and termination as provided for in section 5.04(2).

.04 *Worksite Employees.* The term "Worksite Employees" means employees who receive amounts from a PEO for providing services to a CO pursuant to a service agreement between the PEO and the CO.

.05 **Client Organization.** The term "Client Organization" (CO) means an organization that enters into a service agreement with a PEO under which Worksite Employees provide services to the organization.

SECTION 7. PROCEDURES AND TRANSITIONAL RULE

.01 *Other qualification issues.* (1) Use of EPCRS. Plan qualification issues, other than the exclusive benefit issue for which relief is provided under this revenue procedure, may be resolved under the Employee Plans Compliance Resolution System (EPCRS). See Rev. Proc. 2001-17, 2001-7 I.R.B. 589.

(2) Transitional relief for PEOs. For purposes of determining whether a retirement plan maintained by a PEO for the benefit of Worksite Employees of Cos satisfies the requirements of § 401(a)(2) prior to the Compliance Date, a PEO may treat Worksite Employees as its employees.

(3) Transitional Rule for Code section 416. For purposes of determining whether the Multiple Employer Retirement Plan is top heavy (as defined in § 416(g)(1)(A)(ii)) in its first plan year, the determination date with respect to the first plan year of such plan shall be the last day of such plan year. See § 416(g)(4)(C)(ii).

.02 *Determination letters.* (1) Determination letter application. Any application for a determination letter on the qualified status of any Multiple Employer Retirement Plan adopted and maintained by PEOs and COs that are seeking relief under this revenue procedure shall be made under the relevant provisions of Rev. Proc. 2002-6.

(2) Time of disqualification provision. For purposes of § 1.401(b)-1(b) the Service will treat the requirement that the PEO adopt a Multiple Employer Retirement Plan by the Compliance Date as a disqualifying provision.

.03 *Pending examinations no bar to relief.* A PEO Retirement Plan under examination by the Service is eligible for the relief provided by this revenue procedure.

SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002-6 is modified.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective on May 13, 2002.

DRAFTING INFORMATION

The principal author of this revenue procedure is Jeanne Royal Singley of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue procedure, please contact the Employee Plans taxpayer assistance telephone service at 1-877-829-5500 (a toll-free number), between the hours of 8:00 a.m. and 6:30 p.m. Eastern time, Monday through Friday. Ms. Singley may be reached at 1-202-283-9888 (not a toll-free number).