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IRC Section 415 (e)

by Beverly Rose

IRC section 415(e) has been the source of one of the most complex elements of plan administration. When an individual employee is covered by both a defined contribution and a defined benefit plan of the same employer, current law reduces the maximum benefits which would otherwise be available under the two separate plans. In effect, the limit under 415 (e) can be viewed as limiting the benefit under the second plan to a benefit as low as 25% of the otherwise-applicable limit.

The Small Business Job Protection Act of 1996 ("SBJPA") included as one of its provisions the repeal of section 415(e), effective with plan limitation years beginning on or after January 1, 2000. Newly-issued IRS guidance, in the form of Notice 99-44, comes just in time to alert all to perhaps some unanticipated results of that repeal.

Generally the repeal of the limitation is a welcome change for most plan sponsors, who commonly provide the qualified plan shortfall under a nonqualified arrangement. The repeal allows these benefits to be provided via the qualified plans, which are often well-funded and able to absorb the additional liability with little problem. Employees who have been affected by the limits will also welcome the relief from FICA and FUTA taxes which have been required with respect to amounts payable from the nonqualified plan.

But not all employers may be prepared for the effect of the repeal of the limitation. If the lost benefits have not been made up via an excess plan, in certain circumstances, failure to modify plan provisions prior to January 1, 2000 may create an unexpected expense for the sponsor, and one which may be irrevocable. Notice 99-44 alerts us to some of the potential problem areas, and provides guidance for avoiding some surprises.

There are two major sources of unexpected consequences. First, many plans by their terms have incorporated the limitations of section 415 by reference; under a plan which has been drafted in this manner, the effect of the repeal of 415(e) occurs automatically on the first day of the limitation year beginning after December 31, 1999. Apparently based on the same logic as followed in PLR 9723048, holding that elimination of automatic increases under IRC Section 415(d) are not benefits protected under Section 411(d)(6), Notice 99-44 would allow a plan amendment "to limit the extent to which a Participant's benefit would otherwise automatically increase under the terms of the plan as a result of the repeal of 415(e)." The Service notes that such an amendment would "provide time for the plan sponsor to consider the extent to which a benefit increase . . . should or should not be provided at some later date. . . ." To avoid a violation of Section 411(d)(6), such an amendment must be adopted prior to, and effective as of, the date the repeal would otherwise be effective under the plan, since, based on the reasoning followed in PLR 9723048, the increases generated by the repeal of Section 415(e) become part of the accrued benefit as of the effective date of repeal.

If a plan does not give effect to the repeal of 415(e), plan provisions must be carefully crafted in order to avoid qualification problems. Examples covered in the Notice include the operation of the suspense account in a defined contribution plan, distribution of elective deferrals under a 401(k) plan, or the automatic reduction of benefits under a defined benefit plan to reflect the limitations of 415(e).

Each plan currently must set forth the procedure by which reductions will be affected, due to Section 415(e) being affected. Most plan arrangements limit the accrual under the defined benefit plan, and this limitation may on occasion result in a reduction in the accrued benefit under the defined benefit plan from one year to the next. Such a reduction has been permitted under the terms of Notice 83-10, Q&A G-10. However, the Service now notes that such relief no longer applies, and any reduction would be considered a violation of Section 411 (d)(6). (Notice 99-44, Q&A-8).

When plan provisions cure a violation of Section 415 by reduction in the current accrual under the defined contribution plan, acceptable methods of making the correction required, when contributions and forfeitures exceed the permissible limits, are described in regulation 1.415-6(b)(6). The regulations allow excess amounts to be reallocated to other participants, or held in an unallocated suspense account to be allocated to participant accounts in future years. Since this procedure will no longer be allowed once the reduction is no longer required by statute (i.e., when the annual additions for a defined contribution plan do not exceed the limitations under Section 415 (c), but do exceed the limitations under the cur-rent requirements of Section 415(e)), individual limitations must be determined before the contributions are made and allocated to individual accounts. Similarly, regulation 1.415-6(b)(6)(iv) allows a distribution of elective deferrals or the return of employee contributions, and the gains attributable to those deferrals and contributions, as a method of reducing the excess amounts allocated to an individual account. The plan will not be able to use this correction mechanism for an "excess" which is determined based on the provisions of Section 415(e).

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(continued on page 14, column 1)

IRC Section 415 (e)

continued from page 13

It is important to note that these transactions regarding excess annual additions are also utilized when dealing with the limit under Section 415(c), when the only plan involved is a defined contribution plan. SBJA, which provided for the repeal of section 415(e), also changed the definition of compensation for purposes of Code Section 415(c)(3). Even if a plan bases benefits and accruals on a definition of compensation which is different from the definition under section 415(c)(3), application of the statutory limits and the permitted corrections (as outlined in the preceding paragraph) are based on the statutory definition of compensation. Thus, use of a suspense account would not be permitted for holding "excess annual additions" if determination of that excess is based on a different definition of compensation. Notice 99-44 also includes a reminder of the effect of this change in the definition of compensation.

Although any plan amendment which eliminates the automatic effect of the repeal of Section 415(e) must be adopted prior to the effective date of the repeal, the remedial amendment period under Rev. Proc. 99-33 is available to cure most of the other defects which could occur in a plan which does not intend to take full advantage of the section 415(e) repeal.

The Service also notes that a plan will not satisfy the uniformity requirements of a safe harbor for purposes of satisfying the nondiscrimination requirements of Section 401(a)(4) if the plan does not fully reflect the repeal of section 415(e). (However, if the plan limits benefits using the pre-SBJPA section 415(e) rules only for highly compensated employees, the plan will not fail to satisfy the uniformity requirements of the safe harbor.) Moreover, testing of such a plan under the general test must reflect the limits which continue to apply.

As amounts which will be paid under nonqualified plans may be reduced considerably with the disappearance of 415(e), the question arises as to whether the change can lead to a refund of FICA taxes already paid with respect to the nonqualified plan. To the extent that such taxes were paid as of an "early inclusion" date during 1996 or later, it should be possible to obtain a refund, since these are still open tax years. Practitioners should also examine any frozen benefit plan, to determine the impact of the repeal of Section 415(e) on those plans.

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SOA Services to Pension Actuaries

by Ethan Kra & Judy Anderson

The SOA's Retirement Systems Practice Area Pension Section would like to keep pension actuaries aware of the activities and projects that we are working on. The list of projects and activities below shows services we are providing to pension actuaries. Questions or comments can be directed by email to: *janderson@soa.org.*

• Research projects including:
- Mortality Tables
- Turnover Studies
- "A Benefit Value Comparison of a Cash-Balance Plan with a Traditional Final Average Pay Defined-Benefit Plan"
- "Actuarial Aspects Of Cash Balance Plans"
- Asset Valuation Methods - Survey
- Call for Papers on Effectiveness
- Retirement Needs Framework
- Retirement 2000 Call For Papers & conference
- Mortality Projection Study
- Multivariate Analysis Of Pension Plan Mortality Experience
- Combined Research with Urban Institute on Demographics, Retirement Ages and Plan Provisions
- Macrodemographic Model Study
- Plan Terminations In Ontario
- Public Employee Retirement Systems Study
- Group Annuity Experience Studies
- Safest Annuity Rule Study

• Seminars:
- Social Security Symposia
- Seminar on Estimation
- FAS 87 Seminars
- Annuity Symposium
- Joint Annual Seminars with ALI-ABA

• Meeting sessions and built-in seminars including:
- SOA Spring Pension and Health meeting
- SOA Annual Meeting
- Mergers & Acquisitions Seminar
- ERISA, the Great Debate
- Plan Design from the Employer & Employee Perspective
- Meeting sessions on various technical issues
- Sufficient meeting sessions to fulfill EA Continued Professional Education

• Publications - Print and Online
- *Pension Section News*
- *Pension Forum*
- Hybrid Plan CD-ROM
- Development of pension basics online CD-Rom Program
- Specialty guides
- *Statistics for Employee Benefits Actuaries,* with monthly updates online
- Salomon Brothers Pension Discount Curve and Liability Index
- List serves and online discussion forums
- Web site with many links to employee benefits information

•Education & Examination:
Production of relevant study material