Transcript for Funding-Based Benefit Restrictions Phone Forum

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Moderator: Welcome to the Funding-Based Benefit Restrictions Phone Forum. At this time, all participants are in a listen-only mode. As a reminder, today's conference is being recorded.

I would now like to turn the conference over to your host, Ms. Karen Old.

K. Old: Hello, everyone. I'm Karen Old, Acting Staff Assistant for IRS Employee Plans Customer Education and Outreach. Welcome to our phone forum on funding-based benefit restrictions. Today we will be hearing from Michael Spaid and Tonya Manning, IRS Actuaries with Employee Plans, Rulings, and Agreements.

Before we start, I'd like to point out a couple of things. Everyone registered for this forum will receive a certificate of completion by e-mail approximately one week after the forum. You must attend the entire live forum to receive a certificate. Enrolled agents, enrolled retirement plan agents and enrolled actuaries are entitled to continuing professional education credit for this session. Other types of tax professionals should consult their licensing organization to see if this session qualifies for a continuing professional or educational credit.

As with all of our presentations, the comments expressed by our speakers should not be construed as formal guidance from the IRS. For more information on this topic please visit our retirement plans website at www.irs.gov/retirement. You can also get there by going to the main IRS web page and clicking on the "Retirement Plans Community" tab along the top. To find out more about funding-based benefit restrictions enter the search term "436" in the search bar at the top of the page.

While you're visiting our website you might also want to subscribe to our free electronic newsletters. The link for the newsletters is in left navigation bar. We have two newsletters; *The Retirement News for Employers* and *The Employee Plans News* for retirement plan professionals.

Now, without further ado, here are Michael and Tonya.

T. Manning: Thank you very much. This is Tonya Manning. I would like to set some expectations at the beginning of this presentation. If you've already looked through the slides in the presentation, you should have a pretty good idea about what we're going to talk about.

We will be reviewing the basic rules related to benefit restrictions, which are covered in Section 436 of the Internal Revenue Code. It's going to be a basic review and that's in order to both accommodate the broad range of listeners that we will have for this phone forum, and to accommodate our limited amount of time. A comprehensive review of Section 436 could take many hours.

So we are going to provide you with an update and review of these rules, and at the end we are going to talk a little bit about the impact of PRA, which was not included in the slides. But we'll give you a little bit of a brief update.

This is not being held in reaction or as follow up to any recently released regulations or guidance on Section 436. If you felt that you missed it and that's why the phone forum was scheduled, that is not the case. However, back in December of 2011, Notice 2011-96 was provided. It deals with plan amendments for pension plans related to benefit limits for underfunded plans.

The notice provides a sample amendment that can be used to satisfy the Section 436 limitations. It also provides an extension to the original Section 436 amendment deadline, which you should already be aware of. Also, the notice grants certain relief for anti-cutback requirements. The content of the notice is not the focus of this presentation, but I did want to make sure that everyone was aware of it.

So with that introduction, I'm going to pass it over to Mike. First, he has one recently released piece of guidance not related to the presentation that he would like to update you on, and then we'll dive into the material. Mike?

M. Spaid: I was asked, this is Mike Spaid, I was asked to mention Revenue Ruling 2012-4. It talks about how to satisfy Section 411 and 415 in a defined benefit plan if that plan accepts rollovers from a DC plan and will make distributions and an annuity results from that rollover. It's off topic but important stuff to know in a Revenue Ruling 2012-4.

For 436 we've had PPA around a while and as Tonya said, we don't have anything really new here, but it's such an important topic. A lot of people who may not attend a lot of the conferences where it's been talked about could probably benefit from hearing about it.

Section 436 restrictions only apply to single employer plans. So it doesn't apply to multiemployer plans. There are four kinds of restrictions—easy enough to watch up on the slides. The restrictions can come in at a certain level of funding to restrict payments of unpredictable contingent event benefits, often they're called UCEBs, amendments increasing benefits, accelerated payments. People think of the accelerated payments as a restriction on lump sums and that's certainly correct, but as we will see it can apply to payments other than just lump sums. And it can also affect the cessation of accruals in a plan.

Before we get started to look at those restrictions, we have to determine what can trigger the restriction. We need to look first at something called the AFTAP, but before we do that let's look at the FTAP. And the FTAP is the funding target attainment percentage. It's very simple. It's the assets, reduced by the funding standard carryover balance or the prefunding balance—remember, we have two balances now after PPA—and divided by the liabilities for the plan. And this just gives us a funding ratio.

Well the AFTAP is the same thing, except it's an adjusted funding target attainment percentage. The assets and the liabilities, so in this fraction the numerator and denominator are both adjusted by adding in amounts used to basically buy annuities in the last two years for the non-highly compensated employees.

There's a special calculations option for 2008, 2009, and 2010. And there's a special rule for plans that are fully funded without regard to subtraction of funding balances, in other words, if the AFTAP is 100%. And we will move on to that.

The plan only has one AFTAP at any time. This is a question I was asked at conferences several years ago because there are presumed AFTAPs and AFTAPs you can calculate. But at any one measurement date, there is only one AFTAP. Although it can be a presumed AFTAP, which applies until it's actually determined for the year.

We're going to move on to it in a little bit how it is done. But your presumed AFTAP for any year is based on the prior year's AFTAP, the final certified AFTAP, hopefully certified, with reduction for certain periods and it applies for all or none of the possible restrictions. The presumed AFTAP is the AFTAP until a real one's been made.

We've also allowed, through the new regulations, estimates of the AFTAP in terms of a range certification if real projections and estimates are not allowed, but estimates that you're over a certain amount or between two certain amounts are allowed.

Assets adjustments for balances—don't subtract the funding standard credit balance or the prefunding balance if the FTAP, without subtraction them, is at least 100%. So go on, calculate your FTAP, and if that's 100% you're fully funded at that basis without subtraction of either of these balances. So when you go to calculate your AFTAP do the same thing. And what we're looking for is of course 100% funded here, but there were some transition for 2008, 2009, and 2010 and we show here at 92%, 94% and 96%.

The funding target, when we're calculating that, is the not at-risk liability. Generally, you would only calculate that using the at-risk liability in very narrow circumstances. For instance, if a plan actually is at risk or if the restriction on UCEBs or increasing amendment restriction applies and the employer wants to pay for the amendment, the employer needs to contribute more money to be able to allow for it to happen. It doesn't apply for getting you up to 60% or 80%, and the calculations that could go into the denominator of the AFTAP from being at risk never apply.

Let's look at the prior year's AFTAP. This was a concern when you had a new plan. Obviously there was no prior year's AFTAP. So it's been deemed that the prior year's AFTAP was 100%. If you had a predecessor plan, it would be the predecessor plan's AFTAP.

And there's a note here about terminations. Merger and spinoff rules are reserved in the regulations. The regulations were done to hit the most important and the high parts as best we could. Some of the things to do with, in a sense, its merger and spinoff rules were just reserved for a later date, and I know that updates to those Regs, I don't know when they're forthcoming, but are being considered at this point in time.

T. Manning: They are currently being worked on.

M. Spaid: That's what I mean. They're working on them right now. They're working on them, but when they will be finished we don't know. I wish I could tell you, but I can't.

T. Manning: But not by the end of this presentation.

M. Spaid: No, and it's not that it's a secret. I just don't know.

T. Manning: Right, we just don't know.

M. Spaid: Let's look at the restrictions. We've been talking about if your AFTAP is below a certain amount what could happen. Let's look. If your AFTAP is greater or equal to 100%, there are no restrictions. The plan operates just as it normally would, just as it should. Benefits accrue. Benefits are paid.

If your AFTAP is greater or equal to 80%, but less than 100%, there are not generally any restrictions except if the plan's in bankruptcy. The thing to keep in mind though is if your AFTAP is greater than 80%, but less than 100%, the next year when you're in that period of presumed AFTAPs that could put you into a restriction at that point in time. And we'll see more about that later.

But if your AFTAP is greater than 60%, or equal to but less than 80%, you may not make any amendments increasing benefits and may not be amended as such. And payments that are paid, any payments in excess of the annuity amount that would be otherwise payable are limited to 50% of that or—and this is the part that people forget about quite a bit and I forget as well—is that there's also the present value or the PBGC maximum based on the person's age. So it's the lesser of the two. It's 50% of what could've been paid with no restrictions or the PBGC amount. And that's published in the table from the PBGC.

But if your AFTAP is less than 60% the plan may not pay any unpredictable contingent event benefits. It may not make any amendments increasing benefits whatsoever. It may not pay any accelerated payments. So any payments in access of the annuity amount that would otherwise be payable, may not be paid. And this is the big part is that accruals are frozen. The plan is all of the sudden frozen and the plan may not accrue benefits as long as this restriction applies.

Here we're looking at, on the next slide, the AFTAP based on the current year. If there is no restriction in place for Year 1, then for Year 2 there's no limit on accelerated payments or cessation of accruals until the Year 2 AFTAP is certified, a presumption applies or if you hit October 1^{st}.

The restriction on UCEBs applies but the other restriction doesn't. We're going to talk about what the presumptions are and how that could happen and how the presumptions can then cause you a problem.

So the presumption is we're now in Year 2. We have a plan that was new last year. We're now in Year 2 and we haven't certified the AFTAP yet, which is not uncommon. If you have a plan and maybe it takes a while to get data in, it might take a while to get the assets together. Things like that can delay certification of the AFTAP. We all know that it can delay completion of the work. But if there's a restriction in place for Year 1 then presumptions apply for Year 2 until the AFTAP's certified or October 1^{st}.

So let's look at what those presumptions are. From January 1^{st} to March 31^{st} of the second year of the plan the presumed AFTAP is what it was the prior year. Now if we have a brand new plan and it was 100% last year then it's 100% until March 31^{st}.

From April 1st to September 30th however, if the AFTAP less 10 percentage points, in this case it would put you at 90%, but if you were a plan that was somewhat farther down the road and you were at 82% certified for the prior year, from April 1st to September 30th, providing that the final certification isn't made within that period until that certification is made, your AFTAP is going to be 72%. And if you're at 68% the plan is now at 58%. You can see how that could be.

If the certification is not made by the end of September—I have to back up and say we're talking about a calendar year plan here. I'd like to think everybody should be able to shift the dates back and forth if you have an off calendar year plan—but from October 1st to the end of the year your AFTAP is assumed to be less than 60%. The certification after September 30th of the second year, however, does affect the presumption in Year 3. But the plan is, even if you were to make your certification on October 2nd, the plan is still presumed to have an AFTAP of less than 60% through the end of the year.

Possible changes to the AFTAP after January 1st of the year—let's take a look. We call these the "burn," deemed forfeiture. What it is, is it's just a reduction in the AFTAP. It's like writing off an asset. And what we do here is its reduction in the funding standard credit balance or the prefunding balance.

And there are different circumstances where this could happen. If you have a collectively bargained plan, it would remove any restriction and then you would have a deemed "burn." Do the calculation. If so much of the funding standard credit balance or the free funding balance were to go away would that restriction go away? Then it must be done.

If you have a non-collectively bargained plan, if it were to remove a restriction on accelerated payments, then the plan must "burn," as it's often referred to. It must forfeit parts of the pre-funding balance, the funding standard credit balance, to get the plan out of restriction.

The affective "burn" is by the end of the year in Year 1. Election to make timely contributions—this is something that can happen. If you've got a contribution for a plan year but all of the contributions for the prior plan year haven't been made yet, once those contributions are made that can increase the assets sufficient for the current year to remove restriction.

So if the contribution to be made for the prior year was $100,000, plan year ends, but on July 1st of the next year enough money's put in to bring it up to $100,000 or whatever the amount is going to be contributed and deducted, that can of course increase assets at the beginning of the year and will change the AFTAP for the year.

If there's a plan amendment made security can be provided to increase or to cover the actual additional amount of liabilities that are results of the amendment. But I believe, and Tonya, help me with this, I believe that security has to be provided by the beginning of the year?

T. Manning: I believe that's right. But another point I wanted to make on these "burns", or forfeitures which is the more formal way of saying it, is that once a funding balance is forfeited, even if things change such that you would otherwise have not needed to forfeit that funding balance, you can't revoke it. Once you have a deemed forfeiture, it's pretty much gone.

And there is a certain ordering to this, so you need to be careful when you have these deemed forfeitures and understand the impact that they may have on your quarterly contribution requirements. If you initially thought you were going to use your funding balance to take care of those quarterlies, that may ultimately not work out. Deemed forfeitures can have some unfortunate consequences.

M. Spaid: Absolutely. That's why, as Tonya mentioned in the beginning, this is a pretty high level, from 35,000 feet, presentation because the rules and the application here can become very complex. And not only that, but she just alluded to once change can affect a couple other things in plan. I don't know that I could do a full 436 session in three hours because there's a lot to be done.

T. Manning: You're right. Even three hours would probably be rushed.

M. Spaid: When you said that I thought, "Very fast."

T. Manning: Yes, it depends on how fast we talk.

M. Spaid: But failure to follow these restrictions is bad. It's a violation of 401(a) (29), which is a qualification requirement and it's legal requirement under ERISA. So with the parallel sections between ERISA and Code it's serious and people need to take this very seriously.

Plan termination is a topic that came up. When the Code was first amended by PPA it appeared that if you had a plan that was less than 60% funded and couldn't make any payments in access of an annuity or if the plan was more than 80%, but less than 100% and could only pay perhaps half of a lump sum, let's take for instance a small plan with one participant, you could never pay them out. That was a problem and it's been fixed.

The benefit restrictions do apply after the date of the plan termination. We've had some people coming in and saying: "Well we terminated the plan on 12/31 and some people would like their money. It's now in January and we'd like to pay them out." The answer is no. I'm sorry; I'm assuming the benefit restrictions applied in the year of plan termination.

Benefit restrictions continue to apply until the date that you pay everyone out. And when there's a time when everyone gets their checks written either to buy annuities or to pay for lump sums, at that time the benefit restrictions aren't as much removed as just disregarded at that point.

The issue below talks about where if the AFTAP for the prior year was less than 80% but the plan was funded such that extra money could be put in and they're made after the September 15th deadline, this can make a difference when payments are made. Tonya, do you want to jump in a bit on this?

T. Manning: You can make contributions to implement a plan termination. Even if you're less than 80% funded, you generally can pay annuities and pay out lump sums; otherwise, you would hardly never have a plan termination come into effect.

M. Spaid: But you can't pay on a plan that's terminated until everybody gets paid out.

T. Manning: That's right. The normal plan termination rules still apply. We have received a lot of questions on this topic and this may be something that we want to focus on in another webcast, especially if we begin to see more plan terminations starting to pop up. At the end of the day, you have to be careful as to when you make your contributions versus when you purchase the annuities or pay out lump sums, but you should generally be able to terminate your plans. I think that's all we need to say at this point.

M. Spaid: Absolutely. And this is another one of those topics that Tonya just alluded to that could take quite a while.

Multiple Employer Plans—the question is if you have multiple plans, multiple sponsors adopting one plan how are they created for the restrictions. If the plan is established after '88 or elects to be such each employer's treated as having their own plan. If they were established for '89 and don't make such an election, this restriction would apply on a plan wide basis.

Collectively bargained plans—it's interesting that the regulations include in them a definition of what is meant to be collectively bargained here. And I know that other regulations point back to this regulation or this definition. So be cognizant of this. And it talks about what is a collectively bargained plan. Does everybody in it have to be bargained?

And this talks about 25% are members of a collective bargaining units for which benefits are specified in the plan or 50% of current employees in such collective bargaining units. So the issue, as it points out here, is to look at a lot of older plans, a lot of legacy plans can have a lot of terminated and vested retired people in there.

And we wanted to be able to look at those and have some flexibility to determine if the plan was collectively bargained or not because if so then the deemed burn rule, the forfeitures as we talked about, applies to all the restrictions, and there can be a delayed effective date of the certain sections of the code to these plans. With that, I'll turn it over to Tonya.

T. Manning: Thanks, Mike. I know that when PPA first came out, there were lots of questions about collectively bargained plans' special treatment. They actually have further restrictions and it was initially not clear what the definition of collectively bargained plans was. This was cleared up with regulations. Plan sponsors of a collectively bargained plan need to understand that they have additional requirements or restrictions, such as additional situations that require a deemed forfeiture of funding balances.

It is appropriate that, after talking about collectively bargained plans, we talk about the unpredictable contingent event benefits. I don't think the actual slides are numbered, but I am on the slide numbered 18 in the outline.

So, let's discuss unpredictable contingent events, which you do see often in collectively bargained plans. Sometimes it's easier to define what they are versus what they're not. I'm just going to refer to them as UCEBs. Hopefully everyone can work with that. UCEBs are benefits that are resulting from a full or partial shutdown, or some event that is similar or have a similar effect.

Or, you can define them by what they're not. They are benefits that are paid for an event that is <u>not</u> associated with a person attaining a certain age, performing a certain number of years of service, receipt or derivation of any type of compensation, or with death or disability. So if you have a benefit that is paid out on conditions other than those listed in the second bullet on this slide, or in association with a full or partial shutdown or something that has a similar effect, then those are going to be considered unpredictable contingent event benefits.

So moving on to slide 19 which lists restricted benefits that cannot be paid out if the plan's AFTAP is less than 60%. And, as this slide indicates, you can 'buy your way out'. That's referring to the ability to make a Section 436 contribution.

But you can see that, first of all, let's say at the time the UCEBs would normally be paid, the plan's AFTAP is under 60%. So, if at the time of the triggering event you're funded less than 60%, the amount of the 436 contribution has to be enough to bring the AFTAP back to 60%. So, whatever you determine to be the cost associated with the benefits that are going to be paid out due to the event - that's what you have to fund. And that's even if after you contribute the cost of the benefits, you end up with an AFTAP that is over 60%.

So this is kind of, and this … the cost or the amounts you have to contribute can include at-risk liability even if the at risk-liability of the plan is at risk even though the target liability never includes it when determining the AFTAP. So that's something to be aware of. UCEBs are a tricky little businesses and this is one of those tricky little rules you need to pay attention to.

Now if the plan was funded under 60% after you reflecting the UCEBs—so let's say you were funded 70% before the triggering event, but then once that event triggers the payment of these benefits and you consider the cost of those benefits in your liability, you're AFTAP is then under 60%. Then, the cost or the amount of the contribution that needs to be made to allow those UCEBs to be paid is going to be what gets you just up to that 60% level.

There are special calculations necessary to determine the contribution amount if the actuary hasn't certified the AFTAP yet and there's more than one unpredictable contingent event during the year. You need to look into that if you have one of those special situations. It's a little more straightforward if the AFTAP is already certified or if there's just one triggering event during the year.

Moving on to slide 20; more on UCEBs. Now you could have participants in the plan that have different events at different times. There is more than one event that triggers the UCEB and the AFTAP changed in the interim. If you have this situation, then the last necessary event is the relevant event that's going to be what triggers that UCEB rules.

Now if a participant becomes eligible for the benefit when no restriction is in place, then a later restriction does not affect that participant. This is good news because, otherwise, this would be very confusing for the participant.

For example, if a participant becomes eligible for an unpredictable contingent event benefit and the restrictions are not in place at the time of eligibility, but a month later the AFTAP is now at a point where the UCEB would've been restricted, that's okay. The participant got through the gate, so to speak, when there was no restriction in place. So they're okay and you don't have to go back and undo things.

The plan could be operating under a presumed AFTAP. That's what Mike talked about, when the AFTAP is presumed because the actuary hasn't officially certified it and it is therefore based on last year's AFTAP. Suppose the presumed AFTAP is under 60% so that UCEBs can't be paid, but then later on in the year the AFTAP is certified. If, after considering the cost of all the unpaid UCEBs from earlier in the year, the AFTAP is over 60%, then the plan has to retroactively pay the earlier UCEBs.

So this means that if you have a triggering event where the UCEBs can't be paid out because the plan's AFTAP is presumed to be under 60%, but later on you get the actual AFTAP and you actually could've paid that benefit out. The plan sponsor doesn't get out of paying those UCEBs. What this is basically saying is that they do have to go back and make things right with the participants because it was only the presumed AFTAP that prevented them from receiving a UCEB. But the actual AFTAP, once certified, allowed them to be paid.

Moving on to slide 21. Now we're going to start talking about plan amendments. UCEBs and plan amendments make up two thirds of what I'm covering today, which is just two thirds of half of our presentation. I went back and looked and we have had at prior EA meetings, 90 minute sessions covering nothing but UCEBs and plan amendments - mostly plan amendments.

While we've got several slides in here about plan amendments, if at the end of the presentation you feel like you don't fully understand everything that could possibly happen with plan amendments, you're probably right. They're just extremely complicated. One can think of all kinds of fun and interesting examples where you have multiple amendments within one year, contributions being made in the middle of them, and AFTAPs being presumed and certified around them.

These rules are necessarily complicated. I'm going to give you as much of an understanding as I can given the time constraints and the fact that we're trying to cover all of the different benefit restrictions that are under Section 436. But do know that there is a lot more to be said on this topic and it is quite complicated.

If your fortunate and you only have one plan amendment during the year and your AFTAP's already been certified and all the contributions have been made, you're not in such bad shape. But in other situations you really have to think through and make sure you understand these rules.

So let's take a look at these and we'll start just with the basic rules on slide 21. The basic rules are similar to those for the UCEBs that we just talked about. But here you're going to use an 80% test. So if a plan's AFTAP is under 80%, you can't amend the plan. But you can make a contribution in order to be allowed to amend the plan. The rules work a little bit similar to what you saw with the UCEBs. You can buyout the restriction by paying the cost of the amendment and this would include the at-risk cost, if the plan is in the at-risk status.

Now with that said, the target liability denominator of the AFTAP never includes the at-risk liability. So when you're just paying the cost of the amendment, and the cost is based on the at-risk liability if it's at risk, but when you're testing the AFTAP percentage, that's not based on the at risk liability. So keep that in mind.

If the AFTAP is at least 80%, even after reflecting the cost of the amendment, you're okay. But, if the AFTAP is 80% before the amendment, but once you roll in the liabilities or the cost of amending the plan, the AFTAP drops below 80%, you can make a contribution to allow the amendment. But, you only have to pay enough to get the AFTAP up to just 80%. And this is ignoring the at-risk liability because this rule is focused on the AFTAP and getting the AFTAP to a certain point. So that's why it's not focused on the at-risk liability.

But if you're in the situation where you're having to pay for the cost of the plan amendment because the AFTAP was below 80% before considering the cost of the amendment, then you would include the at-risk liability if the plan is at-risk. Again, nothing's easy about these plan amendments, so make sure you pay special attention to the at-risk liabilities and where you're at with your AFTAP before and after the amendment.

Plan amendments increasing benefits is continued on slide 22. Now, there are lots of questions that we get about when an amendment is considered to have taken effect. If a plan amendment goes into effect, it's not affected by a later decline in the AFTAP to below 80%. So this is similar to the UCEB where, if a participant's event is triggered and they get their UCEB, and it's allowed because the AFTAP is above 60%, they're okay if the AFTAP later drops below 60%.

It's the same thing with the plan amendment. If the plan amendment goes into affect but later on you have a decline in the funding status, it's okay. You don't have to go back and undo that amendment. And I think that's a very good answer. It would be quite complicated on an administrative basis to have to undo amendments.

If the presumed AFTAP is less that 80%, that's going to keep the amendment increasing benefits to be able to take effect without contributions. If the AFTAP is certified later in the same year, and after taking into consideration all of the plan amendments that were not implemented because of restrictions, the AFTAP is over 80%, then the plan must make earlier amendments retroactively effective.

Again, it's very similar to the UCEB. If the AFTAP was presumed under 80% but the actual AFTAP is over 80%, taking into account the amendment and any other amendments that couldn't take place, then you do have to go back and make those earlier amendments. So, you generally will not have any issues with presumed underfunding preventing an amendment that otherwise would've been allowed.

Calculations performed later in the year should consider earlier unpredictable event benefits that were paid out, amendments and Section 436 contributions. You need to keep those in mind. That's what I was referring to earlier where you can have these very complex examples where you had multiple amendments during a year. I've seen some actuaries go over these during sessions at conferences and it amazes me that they could even think of these complex situations.

But I'm sure in real life there are some very complicated situations. You do have to keep taking into account what has happened before as you keep going through these rules and calculations for plan amendments and deciding how much you need to contribute if that's what you want to do to allow the amendments to go into place.

Let's consider amendments where the new plan provisions are adopted on or before the valuation day and take effect before the end of the plan year. The amendment is effective on the first day that any person who is or could be a participant or beneficiary would have a legal right to the increased benefit if the individual were, on that date, to satisfy the requirement or the entitlement to the benefit. Basically, this is saying that the amendment takes effect when someone gets entitled to that benefit and it's protected.

You can think about it as taking effect when the 411(d)(6) protection kicks in; in other words, when the benefit is protected and it cannot be taken away is the time when the amendment is considered effective. If you want to see more about this, go to the Regulations 1.436-1(c)(5). We do get a lot of questions around this, so that would probably be something to add to your notes regarding what to reference to make sure you correctly determine the effective date for an amendment.

Moving on to slide 24. Here, we are still talking about plan amendments increasing benefits. Now, here's something that is interesting. If a plan amendment was reflected for Section 430 purposes, adopted after the valuation date or the start of the plan year (which is typically the valuation date), is effective before the end of the plan year, and there was a 412(d)(2) election made for that amendment, then that amendment needs to be considered and tested to see if the benefit restrictions apply.

Here's a rule that is actually in the Regulations for section 430, not 436, that you need to keep in mind. And if you want to write down the reference it's 1.430(d)-(1)(d)(ii). There, you will find a special rule that sounds very similar to the special rules in 436. It is related, and so we've included it for that reason.

In these regulations, you will see that you might have to count a plan amendment even if you haven't made a section 412(d)(2) election. It's a special rule to fix 'gaming' potential where plan amendments are worded or timed a certain way so that they don't have to go through any kind of section 436 testing. This is to prevent that from happening. Here, you have to recalculate the AFTAP with an increase in normal cost due to the amendment treated as an increase in the funding target for the year.

So you consider the normal cost for the amendment, throw that into the funding target, look at what your AFTAP is and then you decide what's going to be required on the restriction side. If the revised level of the AFTAP would prohibit the plan amendment from taking place, the plan must take the amendment into consideration, properly allocating liabilities to normal cost and funding targets.

So let me give you an example. Let's say you have a plan amendment that has no affect on the funding target, but it's going to have a $100,000 increase in the normal cost for the year. The AFTAP is 80%, right where it needs to be for that amendment to take place.

But if you took the normal cost and added it to the funding target, that's going to push your AFTAP to below 80%. In my example we're right on the edge at 80%. So, if the AFTAP is reduced due to adding that normal cost to the funding target such that the AFTAP is then below the 80% mark; and therefore, the AFTAP would prohibit the plan amendment from taking place, then the plan must take the amendment into consideration. That means you have to reflect the amendment in the Section 43 calculations, but by properly allocating the liabilities to normal cost and the funding target.

So you're only adding the normal cost in to test the AFTAP; you're not actually running your numbers with the funding target artificially increased for the increase in normal cost. It is simply a test to see whether you have to take into account the plan amendment or not.

Hopefully that makes sense. If it doesn't, go to the Regulations and that should hopefully clear things up. Mike, do you have anything you want to add to that?

M. Spaid: Actually I don't. It is something that is important to keep in mind for amendments that don't perhaps increase any past liabilities but will have an effect going forward and to keep that in mind to not just say, "Well the AFTAP's fine." And it is, as you mentioned, in other sections of the code but something here to worry about.

It's complex. If you're not all getting this, and I'm sure a lot of you have already figured this out, this is a fairly complex piece of the Code, the interaction between 430 and 436 is easy to happen and the 436 Regs are worth reading if you haven't. I've actually made myself a directory to them so I have a page-by-page directory. They're fairly substantial.

T. Manning: Yes, and I've benefited from you sharing that directory with me. That's a nice thing to have.

Moving on to slide 25. A plan amendment has the potential of being restricted based on the funding status if it increases the liabilities by reason of one of four different things. It's increasing the liabilities by reason of increasing benefits, which should be obvious, or it's changing the rate of accruals, which again is probably obvious, or if it adds a new or additional benefit to the plan. And the fourth one is if it's changing the right to benefits or changing the vesting schedules.

A plan amendment has to be tested against restrictions if it increases the liability for one of those four reasons. There is an exception in Section 436(b)(3) which is applied separately to each amendment. That's important to know because sometimes, if everything's rolled into one amendment, you can hit restrictions. But, if they're in separate amendments, you may not. Keep in mind that the Section 436(b)(3) exception is applied separately to each amendment.

Now a amendment may not be considered as increasing benefits, even if it's increasing liabilities, and it's therefore not considered increasing benefits. One example is if the plan provides flat rate benefits and there is an increase that's not in excess of the average contemporaneous increase in wages of participants covered by the plan. It is the average of the increase in wages for participants covered by the plan, and that's for all participants, that you consider when deciding if an amendment is considered an increase in benefits.

You can also amend the plan without having to test for Section 436 if the amendment is for statutorily required vesting increases, which is good news. Similarly, you can amend for the restoration of restricted accruals. Mike mentioned at the beginning of our presentation that plans get with an AFTAP below 60% must have their accruals ceased or the plan is frozen.

You could have your plan document written is such a way such that you have an automatic restoration provided in the plan of if the plan's AFTAP drops below 60% and the plan is therefore frozen; but within 12 months, the plan is no longer restricted due to an increase in the AFTAP. In such a case, per the plan, the ceased benefit accruals are restored. In a way it is like it did not happen and the participant gets the service, the benefits, etc. that they would've gotten had that restrictions never kicked in. In that case, you're OK and the restoration is not considered an amendment increasing benefits.

This is a good thing to keep in mind if you have a plan that isn't that well funded or has the potential to become funded below 60. It avoids the administrative hassle of having to track that one-year of accruals that were remedied or corrected within 12 months.

But keep in mind that this test is going to be done on the largest increase in benefits for any group. If you have a plan amendment that's increasing different groups' benefits at different levels, you test the largest increase that any group received. If one group received a 2% increase, a second group received an 8% increase, and the average wage increase overall was 4%, then the group receiving an 8% increase is going to cause the whole amendment to be subject to section 436 testing, even though you had some who were only getting a 2% increase, which is below the average wage increase.

Determine what is the biggest increase that any one group is getting versus the average for the whole group and that's the test. The whole amendment could blow up, so you might want to just implement an amendment that you know is below the average increase, such as pulling out the 2% amendment, in my example.

If the plan operation changes due to an amendment that is later made during a remedial amendment period, you must test the AFTAP as it stood at the time of the operational change, not at the time of the amendment. You do not wait and look at the AFTAP at the time the plan is actually amended.

That's something important to keep in mind, especially if you have things that are improving the funding status between the time the plan operation changed and the time that the amendment was actually made. So that's not going to work if you change your operation after you test.

Contrast this with the situation where there is a retroactive amendment and no participant's benefit increases until the amendment is adopted. If, at the time of the amendment, nothing's changing, and there's no operational change until the amendment is actually adopted, then that's a different situation.

Now for our last part of the presentation, we're going to talk about accelerated payments. These are not a walk in the part either, but I think they are a little easier than some of the rules around plan amendments. But, there certainly are some twists and turns, so let's get into those.

An accelerated payment, as Mike mentioned earlier, is any payment during a month that is in excess of the monthly amount that would be paid under a straight life annuity. If you're getting more then you would get under a straight life annuity in any month, not testing on an annual basis but a monthly basis, then you have what's considered an accelerated payment. And, the purchase of an irrevocable commitment from an insurer to pay benefits counts as a payment.

Any transfer of assets and liabilities to another plan within the same control group is also going to be considered an accelerated payment if it's done with the intent to avoid restrictions. On slide 27 you'll see the portion of the Regulations that deals with this.

Slide 28 talks about if the beneficiary is not an individual, so for example, if you have an estate that is a beneficiary for a participant's benefit upon death. The way you test that is you convert the benefit that's payable to the beneficiary to a monthly installment paid over a 240-month period.

So let's say the estate normally receives a participant's benefit. You convert the participant's benefit into a monthly installment paid over a 240 month period, similar to a 240 month certain benefit, you then apply the same rules on the prior slide 27, but instead of testing it on whether the monthly payments for the death benefit are above what would be paid as a straight life annuity, you're testing against that 240-month period monthly installment.

And if any of those payments are going to be over that 240 monthly installment, then you're going to have what's considered a prohibitive payment. We have the Regulation cite listed on this slide, as well.

M. Spaid: And I wanted to point out that these amounts also—if the plan pays Social Security Supplements and, Social Security could be leveling options, that could be an issue as well. Correct?

T. Manning: Yes. We actually have a slide on that in a second that'll cover.

M. Spaid: I'm sorry. I'm ahead of myself. I was looking at the slides and I missed it.

T. Manning: Let's look at slide 29. You've probably seen a table like this before, or you've created your own. What I like about this particular one is that it actually has the Regulations cites written beside the restriction so that you know where to go to get more information.

On the left column you have the situation. The first one is if the plan has been frozen since 9/1/05, including any Section 415(b) annual increases. On the same row, in the right column, the table indicates that there are no restrictions. Then, as you go down row-by-row, the AFTAP range decreases. If the AFTAP is under 100% and the plan sponsor's in bankruptcy, accelerated payments can't be paid.

And then you go to the next level, the third line, where the AFTAP is 80% or higher but the plan sponsor is not in bankruptcy, then you're back in the no restrictions zone. And then, if the AFTAP is at least 60, but not quite 80%, and the plan sponsor is not in bankruptcy, then you've got the situation that requires bifurcation – we'll talk about this in a minute – where you essentially limit 50% of the payment. And if the AFTAP is under 60%, then the form of payment simply can't be paid. An AFTAP under 60% is not a good place to be, but it is simpler to administer. It's the 60% to 80% range that is the more complicated situation and we'll talk about that in just a second.

Going to slide 30, we have placed the restriction into the form of a flow chart. You should start with the big box on the top left and answer all the questions 'yes' or 'no', follow the corresponding arrow, and you'll figure out whether you're in no restrictions, partial restrictions, or full restrictions.

So the full restrictions were supposed to be shown in red, but the color looks a little more like orange to me, but in any case, full restrictions sort of mean 'stop' and don't pay it. And green indicates no restrictions and you're a go. Hopefully this will be a good reference for you.

Moving on to slide 31, where we will discuss benefits under partial restrictions. When the AFTAP is in the 60% to 80% range, you've got to split the benefit into two pieces. With the illustration of the long bar in the middle of the slide, we are attempting to illustrate how the benefit is going to be split between into the restricted portion and the unrestricted portion.

The restricted portion, of course, is the portion that can't be paid in just any form. It cannot be paid in the form of a prohibitive payment, as described on the prior slides. Unrestricted means you can pay it as you like. And, in the bottom right corner of this slide, you'll see the Regulations that will give you more information on this rule.

Slide 32 does talk a little bit about how you might want to bifurcate a benefit, which is what we were illustrating on slide 31 – bifurcating, or splitting, the benefit into the restricted and unrestricted portions.

Step one: determine the restricted portion. That's the annual payment for the actuarial equivalent straight life annuity plus the social security supplement, if any. What Mike referred to earlier. And step two is to treat the remaining portion as unrestricted. So that's how you bifurcate the benefit. Please refer to 1.436-1(d)(3)(ii) for more information.

Slide 33, determining the prohibited payments. These are determined on a monthly basis. Keep in mind, you're not just looking at the annual benefit, but at what's being paid monthly. I don't think we've emphasized this, but if you have a social security level form of payment, they can be a problem – they are considered accelerated payments because they accelerate payments during the period before social security starts and then lower the payments afterwards.

Social security level options are typically going to create the situation where the participant's getting a monthly benefit that's greater than what they would get with a straight life annuity for the period up to where the leveling occurs or where the social security payments begin. Again, you're testing on a monthly basis, not an annual basis.

It applies with any payments greater than the actuarial equivalent straight life annuity monthly payment (plus the social security supplement) with the same annuity starting date. So we are looking and testing payments with the same annuity starting date.

Determine the monthly payment under the optional form of benefit and then look at the smallest monthly payment that will be paid under the payment form during the life expectancy of the participant. That's usually $0, and if so, then the excess is going to be the prohibitive payment.

That was a pretty quick run through of what we have for today on the benefit restrictions. As mentioned earlier, there is much more that can be said on these restrictions and many sessions have taken 90 minutes just to cover one of these types of restrictions.

Just real quickly I just want to mention that there was an impact on benefit restrictions in the Pension Relief Act of 2010. You do need to be aware that there is some impact from that Act. The Act provided relief for restrictions on benefit accruals, and for social security level optional forms of payment, the ones we just talked about where the monthly benefit is reduced at the time Social Security is assumed to start.

For plan years beginning between October 2008 and October 2010, a plan must replace what would normally be determined as the AFTAP with the AFTAP what we call the 'lookback' AFTAP, an AFTAP for the first plan year beginning from 10/1/07 to 9/30/08.

Since, for most plans, the AFTAP for 2008 through 2010 was higher before 10/1/08, the AFTAP is usually increased above what the AFTAP would normally be for the period that the relief applies. As a result, certain restrictions that would otherwise apply do not apply for the limited period. Be careful though. It's only for the restrictions that I mentioned earlier, which are on benefit accruals and social security level options. The relief is not applied for paying other forms of payment or for other restrictions, such as plan amendments.

This rule is required – not optional, so you do have to do that replacement. Remember at the beginning of our presentation, Mike stated that you have only one AFTAP, he was correct, except for areas where the Pension Relief Act applies. The Act allows you to use a substitute AFTAP, but just for certain purposes for certain plan years.

I think with that, we are exactly at 3:00, or maybe one minute late, so I will let our host close the call, unless Mike has any closing comments.

M. Spaid: No, I'm done and you were right at the very end.

K. Old: Thank you, everybody for joining us at the IRS phone forum. We look forward to
having you at a future phone forum.

Moderator: That does conclude our conference for today. Thank you for your participation and for using AT&T TeleConference Service. You may now disconnect.