

Transition Guidance for New Funding Rules and Funding-Related Benefit Limitations under PPA '06

Notice 2008-21

I. PURPOSE

This notice announces a later effective date than originally proposed for certain proposed regulations under §§ 430 and 436 of the Internal Revenue Code (Code), as added by the Pension Protection Act of 2006, Public Law 109-280 (PPA). In addition, this notice provides transitional guidance for 2008 under § 436 for small plans with end-of-year valuation dates.

II. BACKGROUND

Section 412 provides minimum funding requirements that generally apply for defined benefit pension plans. Section 430, which was added by PPA, specifies the minimum funding requirements that apply to single employer pension plans (including multiple employer plans) pursuant to § 412.

Section 430(h)(3) provides rules regarding the mortality tables to be used for purposes of determining any present value or making any other computation under § 430. Section 430(h)(3)(C) provides rules for a plan sponsor's use, with the approval of the Secretary, of employer-specific substitute mortality tables in lieu of the standard mortality tables that are otherwise used under § 430(h)(3)(A). On May 31, 2007, proposed regulations under § 430(h)(3)(C) were published in the Federal Register as § 1.430(h)(3)-2 (72 FR 29456). Rev. Proc. 2007-37, 2007-25 I.R.B. 1433, sets forth standards and procedures for obtaining approval to use substitute mortality tables.

Section 430(f) provides for certain funding balances referred to as the prefunding balance and the funding standard carryover balance to be used to reduce the otherwise applicable minimum required contribution for a plan year. On August 31, 2007, proposed regulations under § 430(f) were published in the Federal Register as § 1.430(f)-1 (72 FR 50544).

Section 401(a)(29) requires that a defined benefit plan (other than a multiemployer plan) satisfy the requirements of § 436. Section 436 sets forth a series of limitations on the accrual and payment of benefits under an underfunded plan. Section 436(b) places limitations on the payment of plant shutdown benefits and other unpredictable contingent event benefits, § 436(c) places limitations on plan amendments that increase

liabilities for benefits, § 436(d) places limitations on the payment of accelerated benefit distributions, and § 436(e) places limitations on benefit accruals. These limitations are applied based on the plan's adjusted funding target attainment percentage (AFTAP) for the plan year, as certified by the plan's enrolled actuary.

Section 436(j) provides definitions that are used under § 436, including the definition of a plan's AFTAP. In general, a plan's AFTAP is based on the plan's funding target attainment percentage (FTAP) under § 430(d)(2) for the plan year. However, the plan's AFTAP is determined by adding the aggregate amount of purchases of annuities for employees other than highly compensated employees (within the meaning of § 414(q)) made by the plan during the two preceding plan years to the numerator and the denominator of the fraction used to determine the FTAP.

Section 436(h) sets forth a series of presumptions that apply during the portion of the plan year that is before the plan's enrolled actuary has certified the plan's AFTAP for the year. Under § 436(h)(3), if any of the § 436 limitations did not apply to the plan for the preceding year, but the AFTAP of the plan for the preceding year was not more than 10 percentage points greater than the percentage that would have caused a limitation to apply to the plan for the preceding year and, as of the first day of the 4th month of the current plan year, the enrolled actuary of the plan has not certified the actual AFTAP for the current plan year, then, until the enrolled actuary certifies the plan's actual AFTAP for the current plan year, the plan's AFTAP for the current plan year is presumed to be equal to 10 percentage points less than the AFTAP of the plan for the preceding plan year. Under § 436(h)(2), if the plan's enrolled actuary has not certified the plan's AFTAP by the first day of the 10th month of the current plan year, the plan's AFTAP for the current plan year is conclusively presumed to be less than 60 percent as of that day.

Section 430(g)(1) provides that all determinations made under § 430 for a plan year (including the determination of a plan's FTAP and AFTAP) must be made as of the plan's valuation date. Section 430(g)(2) provides that, other than for small plans with 100 or fewer participants (determined as provided in § 430(g)(2)(B) and (C)), the valuation date for a plan year must be the first day of the plan year.

Section 436(k) provides that, for purposes of § 436, in the case of plan years beginning in 2008, the FTAP for the preceding plan year may be determined using such methods of estimation as the Secretary may provide.

Proposed regulations under § 436 were published as § 1.436-1 on August 31, 2007 (72 FR 50544).¹ Section 1.436-1(j)(2) and (3) of the proposed regulations would provide rules for determining the FTAP and AFTAP for purposes of applying the § 436 benefit limitations. Section 1.436-1(j)(3)(iii)(B) provides that, for purposes of determining the plan's AFTAP for the first year § 436 applies to the plan, the adjusted funding target is equal to the current liability determined pursuant to § 412(l)(7) as of the plan's valuation date for the plan year that precedes the first plan year for which § 436 applies to the

¹ A correction notice was published with respect to this notice of proposed rulemaking in the Federal Register dated November 9, 2007 (72 FR 63528).

plan, increased by the aggregate amount of purchases of annuities for employees other than highly compensated employees (as defined in § 414(q)) which were made by the plan during the preceding 2 plan years.

Proposed § 1.436-1(j)(3)(iv) provides that, in any case in which the plan's enrolled actuary has not issued a certification of the AFTAP of the plan for the plan year preceding the plan year § 436 first applies to the plan (the pre-effective plan year), the AFTAP of the plan for the plan year is presumed to be less than 60 percent until the AFTAP of the plan for that pre-effective plan year has been certified. Under the proposed regulations, this rule applies for purposes of § 1.436-1(b) and (c) at the beginning of the first plan year that § 436 applies to the plan and applies for purposes of § 1.436-1(d) and (e) as of the first day of the fourth month of the first plan year that § 436 applies to the plan. The guidance set forth in the proposed § 436 regulations with respect to application of these presumptions does not address how the rules of § 436(h) apply to a plan with a valuation date that is not the first day of the plan year. See proposed § 1.436-1(h)(5).

On December 31, 2007, proposed regulations under §§ 430(d), 430(g), 430(h), and 430(i) were published in the Federal Register (72 FR 74215). Those regulations are proposed to apply to plan years beginning on or after January 1, 2009.

III. TRANSITIONAL GUIDANCE

A. Delay of effective date of regulations under §§ 430(f), 430(h)(3)(C), and 436

In order to maintain a uniform effective date for guidance under § 430, this notice announces that, when regulations proposed under § 1.430(f)-1 (regarding maintenance of certain funding balances) and § 1.430(h)(3)-2 (regarding substitute mortality tables) are finalized, those final regulations will not apply to plan years beginning before January 1, 2009.² In addition, because of the close interaction between the § 430 and § 436 rules and requirements, when regulations proposed under § 1.436-1 are finalized, those final regulations also will not apply to plan years beginning before January 1, 2009. For plan years beginning during 2008, taxpayers must follow applicable statutory provisions and can rely on the proposed regulations for compliance with those statutory provisions. Taking into account the items with respect to which guidance is provided in this Part III(A), the Service will not challenge a reasonable interpretation of an applicable statutory provision under § 430 or 436 for plan years beginning during 2008.

In applying the statutory provisions of §§ 430 and 436 for plan years beginning during 2008, taxpayers should note the following:

² It is planned that, when proposed § 1.430(h)(3)-1 (which provides generally applicable mortality tables) is finalized, that section will apply to plan years beginning on or after January 1, 2008, as originally proposed.

- Although § 1.430(h)(3)-2 will not apply to plan years beginning before January 1, 2009, taxpayers can use substitute mortality tables for plan years beginning during 2008 only if those mortality tables are approved by the Service under the procedures set forth in Rev. Proc. 2007-37.

- Under § 430(g)(3)(B), the use of averaging methods in determining the value of plan assets is permitted only in accordance with methods prescribed in Treasury regulations. Accordingly, under current law, for plan years beginning in 2008, taxpayers cannot use asset valuation methods other than fair market value (as described in § 430(g)(3)(A)) except as provided in the Treasury regulations. The final regulations will permit the averaging method set forth in the proposed regulations to apply for plan years beginning during 2008.

- Under § 436(k), for purposes of § 436, in the case of plan years beginning in 2008, the FTAP for the preceding plan year may be determined using such methods of estimation as the Secretary may provide. Thus, methods of estimating the FTAP for the 2007 plan year can be used for purposes of applying the rules of § 436 for the 2008 plan year only if those methods are permitted in Treasury regulations. Final regulations will permit the estimation methods set forth in the proposed regulations to be used for the 2008 plan year, and will also permit the rules set forth in Part III(B) to be used for this purpose for small plans with end-of-year valuation dates. Taxpayers should not assume that other methods will be permitted except as set forth in published guidance.

For plan years beginning during 2008, benefit restrictions under § 436(d) and (e) will apply beginning with the first day of the fourth month of the plan year if no certification of the plan's AFTAP for either the prior plan year or the current plan year is received by that date. In addition, in the case of a plan amendment or plant shutdown or other unpredictable contingent event occurring on or after the first day of a plan year beginning during 2008, the benefit limitations of § 436(b) and (c) must be applied based on the AFTAP certified for the current plan year, or, if no such certification has yet been received, on the AFTAP certified for the prior plan year except as provided under § 436(h)(2) or § 436(h)(3). Without the transition guidance provided in Part III(B) of this notice, the enrolled actuary's certification of the prior year AFTAP for a small plan with an end of year valuation date could not readily be made before these rules would apply. Therefore, in the absence of such transition guidance, the AFTAP of such a plan for the plan year beginning in 2008 would be presumed to be less than 60 percent as of the first day of the fourth month of that plan year for purposes of the limitations under § 436(d) and (e) (and the AFTAP of such a plan would generally be considered to be less than 60 percent in the case of a plan amendment or plant shutdown or similar event as of the first day of the 2008 plan year pursuant to the rules of § 436(b) and (c)).

B. Transition rule for application of § 436 benefit limitations by small plans with end of the plan year valuation dates

In the case of a plan that, under § 430(g), has a valuation date that is the last day of the plan year for each of the plan years beginning in 2006, 2007, and 2008, for purposes of

applying the benefit limitations of § 436 for the plan year beginning during 2008, a certification of the plan's AFTAP for the prior plan year (the 2007 plan year) is permitted to be made by determining the FTAP for the 2007 plan year as follows:

- The FTAP for the 2007 plan year is equal to a fraction (expressed as a percentage), the numerator of which is the value of net plan assets as determined below, and the denominator of which is the plan's current liability determined pursuant to § 412(l)(7) on the valuation date for the second plan year that begins before 2008 (the 2006 plan year), including the increase in current liability for the 2006 plan year.
- For purposes of determining the FTAP for the 2007 plan year, the value of net plan assets is determined as the value of plan assets under § 412(c)(2) as in effect for the 2006 plan year, adjusted as follows: (1) contributions made for the 2006 plan year are taken into account, regardless of whether those contributions are made during the plan year or after the end of the plan year and within the period specified under § 412(c)(10); (2) the value of plan assets taking into account the amount of contributions made for the 2006 plan year is increased or decreased, as necessary, so that it is neither less than 90 percent of the fair market value of plan assets nor greater than 110 percent of the fair market value of plan assets on the valuation date for the 2006 plan year (taking into account assets attributable to contributions for the 2006 plan year); and (3) the plan's funding standard account credit balance as of the end of the 2006 plan year is subtracted (unless the value of plan assets is greater than or equal to 90 percent of the plan's current liability determined under § 412(l)(7) on the valuation date for the 2006 plan year).

A plan that determines the prior year AFTAP for the 2008 plan year in accordance with the rules of this Part III(B) cannot increase plan assets for purposes of this computation through elective reduction of the 2008 prefunding balance. If the plan sponsor wishes to increase plan assets for purposes of determining the prior year AFTAP through elective reduction of the prefunding balance, the plan sponsor should use generally applicable rules for determination of the prior year AFTAP (which would require use of the plan's 2007 valuation rather than the plan's 2006 valuation).

IV. COMMENTS REQUESTED AND FUTURE REGULATIONS

The transitional guidance provided in Part III applies for plan years beginning in 2008. Section 2(c)(2)(F) of both S. 1974 (passed by the Senate on December 19, 2007) and H.R. 3361 (as introduced in the House of Representatives), which would provide technical corrections to provisions enacted under PPA, would add a new provision to § 436 to provide the Secretary of the Treasury with authority to prescribe rules for the application of § 436 to plans with valuation dates other than the first day of the plan year. If statutory authority similar to that in these technical correction provisions is enacted, the IRS and the Treasury Department are considering including rules in the final regulations substantially similar to those set forth in Part III(B) for the determination of the prior year AFTAP for a plan with an end-of-year valuation date with respect to plan years after 2008. Similarly, if such authority is enacted, the IRS and the Treasury

Department are considering including rules in the final regulations under which the certification of an AFTAP as of the last day of the prior plan year will be treated as the certification of the AFTAP for the current plan year for a plan with an end-of-year valuation date. The IRS and the Treasury Department are not contemplating any additional special rules under § 436 for small plans that have a valuation date other than the first day of the plan year. Thus, a plan with a mid-year valuation date may have difficulty in obtaining the required actuarial certification in time to avoid the imposition of benefit limitations under § 436. Comments are requested regarding the proposals set forth in this Part IV and whether there is a need for any other special rules for plans with valuation dates other than the first day of the plan year.

Written comments should be submitted by April 21, 2008. Send submissions to CC:PA:LPD:DRU (Notice 2008-21), Room 5203, Internal Revenue Service, POB 7604 Ben Franklin Station, Washington, D.C. 20044. Comments may be hand delivered between the hours of 8 a.m. and 4 p.m., Monday through Friday, to CC:PA:LPD:DRU (Notice 2008-21), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically via the Federal eRulemaking portal at <http://www.regulations.gov> (Notice 2008-21). All comments will be available for public inspection.

DRAFTING INFORMATION

The principal authors of this notice are David Ziegler of the Employee Plans, Tax Exempt and Government Entities Division, and Lauson C. Green and Linda S. F. Marshall of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, please contact Mr. Ziegler via e-mail at RetirementPlanQuestions@irs.gov, or you may contact Mr. Green and Ms. Marshall at (202) 622-6090 (not a toll-free number).