December 9, 2009

TCRS 2009-15: IRS Issues Final Guidance On Section 204(h) Notice Requirements Post PPA

On November 24, 2009, the Internal Revenue Service (IRS) published final regulations providing guidance on the application of the section 204(h) notice requirements to a pension plan amendment that permits reduction of benefits accrued before the plan amendment date. These final regulations also reflect certain amendments made to the section 204(h) notice requirements by the Pension Protection Act of 2006 (PPA). Important guidance on how the section 204(h) notice requirements may be satisfied through other notices issued by a pension plan is also included in these final regulations. These final regulations are effective November 24, 2009 and generally apply to section 204(h) amendments that are effective on or after January 1, 2008. Special effective dates apply to certain changes described below.

Background

Section 204(h) of the Employee Retirement Income Security Act of 1974, as amended, (ERISA) requires that affected participants (and certain other parties) be provided advance notice of any pension plan amendment that would result in a significant reduction in the rate of future benefit accruals. For this purpose, the elimination or reduction of an early retirement benefit or retirement-type subsidy is treated as having the effect of reducing the rate of future benefit accruals. ERISA section 204(h) requires that such notice be provided within a reasonable time prior to the effective date of the pension plan amendment. This notice is referred to as the "section 204(h) notice" and a pension plan amendment that requires a section 204(h) notice is referred to as a "section 204(h) amendment." Section 4980F of the Internal Revenue Code of 1986, as amended, (IRC) and the regulations thereunder, contain notice requirements that parallel those of ERISA section 204(h) and imposes an excise tax for failure to comply with the notice requirements.

The requirement to provide a section 204(h) notice applies to defined benefit plans under IRC sections 401(a) (including cash balance plans) and 403(a), and individual account plans that are subject to the funding standards of IRC section 412, such as money purchase and target benefit plans.

In March, 2008, the IRS published proposed regulations that clarified the section 204(h) notice requirements and provided guidance relating to several changes made by PPA.

Final Regulations

The changes made by these final regulations apply to ERISA section 204(h) and IRC section 4980F and, where applicable, the regulations thereunder.

PPA-Related Changes

- If a section 204(h) notice is required to be provided with respect to a pension plan amendment relating to a multiemployer plan, any employer that has an obligation to contribute to the multiemployer plan must also be provided with the section 204(h) notice. This requirement does not apply to a single employer plan. This provision applies to section 204(h) amendments adopted in plan years beginning on and after January 1, 2008.
- In the case of a section 204(h) amendment to a pension plan maintained by an employer that is a commercial passenger airline or the principal business of which is providing catering services to a commercial passenger airline, the section 204(h) notice must be provided within 15 days of the effective date of the section 204(h) amendment. This provision applies to section 204(h) amendments adopted in plan years ending after August 17, 2006.

- The final regulations provide that any plan amendment made to comply with PPA may be retroactively effective and will not violate the anti-cutback rules of IRC 411(d)(6), if the amendment is adopted by the last day of the plan's 2009 plan year (2011 in the case of a governmental plan) and the conditions listed in section 1107(b)(2) of PPA are satisfied.

Plan Amendments Reflecting a Change in Statutorily Mandated Minimum Present Value Rules

According to the final regulations, a section 204(h) notice is not required if a defined benefit plan is amended to reflect changes to the applicable interest or mortality assumptions in IRC section 417(e)(3) as a result of the amendment by PPA. Certain exceptions apply. IRC section 417(e)(3) provides the actuarial assumptions for calculating the minimum present value of a participant's accrued benefit.

Interaction of the Section 204(h) Notice Timing Rules With Plan Amendments That Have A Retroactive Effective Date

- The final regulations provide that (1) a benefit that is not a protected benefit, (2) a benefit that is a protected benefit but that may be eliminated or reduced as permitted in IRC section 411(d)(6) and the regulations, and (3) the adoption of a retroactive plan amendment to comply with section 1107 of PPA, are not considered in determining whether a pension plan amendment is a section 204(h) amendment. As a result, a pension plan amendment relating to these provisions is not a section 204(h) amendment; therefore, no section 204(h) notice is required.
- Under the final regulations, in the case of an amendment that is permitted to be adopted retroactively, the effective date of the amendment is the date the amendment is put into effect operationally and a section 204(h) notice is required to be provided at least 45 days (15 days for a multiemployer plan amendment) before the amendment is put into effect operationally. This provision is effective for section 204(h) amendments adopted in plan years beginning after July 1, 2008.
- A special transitional rule is included in the final regulations which applies to a statutory hybrid plan (such as a cash balance plan). Under this transitional rule, if such a plan is amended to reduce benefit accruals, a section 204(h) notice must be provided at least 30 days before the amendment is effective. If the statutory hybrid plan was first effective before January 1, 2009, and the amount of distribution under the plan is limited to the participant's account balance, the section 204(h) notice will be deemed timely if provided at least 30 days before the section 204(h) amendment is first effective. Thereafter, the general timing rule applies. Under the general timing rule, a section 204(h) notice must be provided at least 45 days before the effective date of any section 204(h) amendment.
- According to the final regulations, in the case of a plan amendment reducing the rate of future benefit accruals with a retroactive effective date, the determination of whether such a reduction is significant is to be made taking into account the relevant facts and circumstances at the time the amendment is adopted, or if earlier, at the effective date of the amendment.

Special Rules for Section 204(h) Notices Provided in Connection with other Notice (Disclosure) Requirements

In order to eliminate the need to provide multiple notices in situations where a section 204(h) notice is required in addition to another notice, if a plan provides one of the notices below, the plan is treated as timely providing a section 204(h) notice with respect to a section 204(h) amendment.

- A notice required under any revenue ruling, notice or other guidance relating to a retroactive plan amendment described in IRC section 412(d)(2);
- An ERISA notice relating to an amendment that is adopted to comply with the benefit limitation requirements of ERISA;
- A notice required for an amendment to comply with the benefit restrictions (because a plan is underfunded) of IRC section 432(f)(2);
- An ERISA notice for an amendment that reduces or eliminates accrued benefits from employer contributions in a multiemployer plan in reorganization;
- An ERISA notice relating to the effects of the insolvency status for a multiemployer plan; and

- An ERISA notice for an amendment of a multiemployer plan reducing benefits pursuant to ERISA.

Future Guidance

The final regulations state that the IRS and Treasury will be issuing guidance in the future which will address the following:

- The interaction of the IRC section 432(e)(8)(c) notice (relating to multiemployer plans in endangered or critical status) with the requirements for a section 204(h) notice; and
- Application of IRC section 4980F to plan amendments made pursuant to PPA section 1107 to comply with IRC section 411(b)(5)(B)(i) relating to market rates of return.