IRS Issues Final Regulations on the Determination of Minimum Required Contributions for Single Employer Defined Benefit Plans

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On September 9, 2015, the Internal Revenue Service ("IRS") issued final regulations on determining minimum required pension contributions under Internal Revenue Code ("Code") section 430 for single employer defined benefit pension plans for plan years beginning on or after January 1, 2016. Code section 430 was added by the Pension Protection Act of 2006 ("PPA"), as amended by the Worker, Retiree, and Employer Recovery Act of 2008 ("WRERA"), the Moving Ahead for Progress in the 21st Century Act of 2012 ("MAP–21") and the Highway and Transportation Funding Act of 2014 ("HATFA"). The final regulations also reflect guidance on the excise tax for failure to satisfy the minimum funding requirements for both single employer and multiemployer defined benefit pension plans under Code section 4971, as amended by the Cooperative and Small Employer Charity Pension Flexibility Act of 2014 ("CSEC Act"). This article highlights some of the key provisions of the final regulations.

Background

Code section 430 sets forth the minimum funding requirements that apply to single employer defined benefit plans (which, for these purposes, include multiple employer plans) pursuant to Code section 412. Generally, the amount of the minimum required contributions for the plan year is determined by comparing the value of plan assets (less the sum of the plan's prefunding balance and funding standard carryover balance) to its funding target. If the value of plan assets is less than the funding target, Code section 430 defines the minimum required contributions as the sum of the plan's target normal cost and the shortfall and waiver amortization charges for the plan year. If the value of plan assets equals or exceeds the funding target, Code section 430 defines the minimum required contribution as the plan's target normal cost for the plan year reduced (but not below zero) by the amount of the excess. Code section 430 also addresses how to determine the shortfall amortization base and the interest rates that must be used in determining a plan's target normal cost and funding target.

Under Code section 430(j), the due date for payment of any minimum required contributions for a plan year is eight and one-half months (8 1/2) after the end of the plan year. Generally, any payment made on a date other than the valuation date for the plan year must be adjusted for interest accruing at the plan's effective interest rate under Code section 430(h)(2)(A) for the plan year for the period between the valuation date and the payment date. Under Code section 430(j)(3), if the

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plan had a funding shortfall for the preceding plan year, the plan sponsor must pay certain quarterly installments toward the required minimum contributions for the plan year. Each quarterly installment is generally twenty-five percent (25%) of the required annual payment. If a quarterly installment is made after the applicable due date, then the interest rate that applies for the underpayment period is the plan's effective interest rate plus five percentage points.

Code section 4971(a) imposes an excise tax on the employer for a failure to meet its applicable minimum funding requirements. In the case of a single-employer pension plan, the tax is generally ten percent (10%) of the aggregate unpaid minimum required contributions for all plan years remaining unpaid, as of the end of any plan year ending with or within a taxable year.

On April 15, 2008, the IRS proposed rules providing plan sponsors of single employer defined benefit plans with guidance on minimum required contributions under Code section 430 and the applicable excise taxes under Code section 4971, as summarized above. The final regulations are similar to the proposed regulations, but make some changes, including changes to reflect WRERA, the CSEC Act and HATFA.

Highlights of the Additions or Changes in the Final Regulations

The additions or changes in the final regulations include the following:

- Under the proposed regulations, liquidity shortfalls could only be corrected through contributions, and the excise tax would apply for every quarter until the liquidity shortfall for a quarter was corrected through contributions. In response to comments, the final regulations provide that a payment of the liquidity shortfall is treated as unpaid until the close of the quarter in which the due date for the installment occurs (without regard to any contribution of liquid assets that is made after the due date of the required installment).

- In response to comments, the final regulations provide a special rule for applying the liquidity requirement to multiple employer plans. Under these rules, the liquidity requirement is treated as satisfied if the requirement would be satisfied if the plan was a single employer plan. If it is not satisfied on that basis then the rules must be applied separately to each employer under the plan, as if each employer sponsored its own plan.

- The proposed regulations provided that contributions are first treated as satisfying the quarterly installment requirement without regard to the liquidity requirement. So that all contributions of liquid assets apply toward satisfaction of the liquidity requirement, the final regulations provide that any contribution of liquid assets for a quarter applies t oward satisfying the liquidity requirement (as well as the otherwise applicable quarterly installment).

- The final regulations clarify that if a plan terminates before the last day of a plan year, the plan is treated as having a short plan year that ends on the termination date. As a result, the minimum required contribution for such a plan is determined based on that short plan year. If a plan terminates before the date that would otherwise have been the valuation date for a plan year, then the valuation date for the plan year must be changed so that it falls within the short plan year. Also, any minimum required contributions for the year of plan termination is due eight and one-half (8½) months after the termination date.

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- The final regulations add a technical correction to the first segment interest rate in Code section 430(h)(2)(B)(i) to reflect modifications made under section 2003(d) of HATFA. The final regulations also add an interest credit at the plan's effective interest rate on a contribution made to meet a required quarterly installment for the period from the contribution payment date to the due date for the installment, which is intended to reduce the amount that needs to be contributed when making payments in advance of a due date.
- The final regulations permit a plan sponsor to provide the plan's enrolled actuary with a written standing election to use the plan's prefunding and carryover balances to satisfy quarterly contribution obligations. This standing election is deemed effective on the later of the last date for making the required quarterly contribution and the date the standing election is provided to the enrolled actuary. The standing election remains in effect until revoked, suspended, or replaced, or until the enrolled actuary is changed. A standing election may need to be revised once the minimum required contribution for the year is determined.
- The final regulations set forth definitions that apply for purposes of applying the excise tax rules of Code section 4971, which are substantially the same as the definitions in the proposed regulations but include certain modifications reflect the CSEC Act.

Effective Date

The final regulations were effective on September 9, 2015, and apply to plan years beginning on and after January 1, 2016. However, for plan years beginning before 2016 and after 2007, a plan sponsor may rely on either these final regulations or the proposed regulations published in 2008.

Conclusion

The final regulations under Code section 430 are highly technical and include detailed instructions for plan sponsors and actuaries beyond what is addressed in this article. Sponsors of single-employer defined benefit plans should review the final regulations with their actuary to determine whether and how they affect their plans and funding policy.

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