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Pension ANALYST

Compliance Bulletin

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IRS Issues PPA Lump Sum Guidance

A defined benefit pension plan must determine the present value of a lump sum payment using the "applicable interest rate" and the "applicable mortality table" provided by the IRS. The Pension Protection Act of 2006 (PPA) redefined both of these terms and the IRS has recently provided guidance regarding these requirements.

Applicable Interest Rate

For plan years beginning on or after January 1, 2008, the applicable interest rate is determined by applying an adjusted corporate bond-based yield curve. This curve is divided into three segments, based on the number of years over which the annuity would be paid. As a result, there will be different effective interest rates for each participant, based on their ages. A plan may phase–in these new rates over a five-year period, at 20% per year. Under the phase-in rules, the applicable interest rate for 2008 will equal 80% of the applicable pre-PPA 30-year Treasury yield plus 20% of the new corporate bond-based rate.

IRS Revenue Ruling 2007-67 confirms that the pre-PPA stability and lookback period rules continue to apply for plan years beginning on or after January 1, 2008. The stability period is the length of time the interest rate is held constant. Monthly, quarterly, and annual stability periods are permitted. The lookback period defines which rates are used for lump sum calculations and may be up to five months before the start of the stability period. If the first day of a plan's 2008 plan year does not coincide with the first day of its stability period, different interest rates will apply to payments with annuity starting dates before and after the effective date of the PPA change.

Applicable Mortality Table

In Revenue Ruling 2007-67, the IRS describes the "applicable mortality table" as the "2008 Applicable Mortality Table," which is based on both the actual experience of pension plans and projected trends in that experience. This table is based on a fixed blend of 50% of the static male combined mortality rates and 50% of the static female combined mortality rates. The IRS will publish updated mortality tables in future years.

In general, the applicable mortality table for any given year applies to payments with annuity starting dates that occur during stability periods that begin during the calendar year to which the applicable mortality table applies. However, the 2008 Applicable Mortality Table does not apply before the first day of a plan's 2008 plan year. As a result, the IRS provides special rules for applying the new mortality table to a plan with a non-calendar plan year.

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For example: In the case of plan with a September 1 to August 31 plan year, and a calendar year stability period, the 2008 Applicable Mortality Table (as well as the applicable interest rates based on the three segment rates) would not apply to payments with annuity starting dates occurring before September 1, 2008, but would apply to payments with annuity starting dates occurring on or after September 1, 2008.

Anti-Cutback Relief

The IRS has indicated that an amendment replacing the pre-PPA applicable interest rate and applicable mortality table with the PPA interest rate and mortality table for plan years beginning on or after January 1, 2008, will not violate the anti-cutback rules. These changes are not considered reductions in accrued benefits or in the amount of payments. However, if a plan had a pre-PPA interest rate that was not the 30-year Treasury rate and is now replacing it with the PPA interest rate, that amendment must satisfy the anti-cutback rules.

In a recently released newsletter, the IRS has indicated that it will issue proposed regulations that will not require plan sponsors to provide participants with benefit accrual reduction notices ("204(h) notices") for plan amendments that:

- Substitute the new PPA actuarial assumptions for the pre-PPA actuarial assumptions described above; or
- Restrict benefits for certain underfunded plans (since separate participant notice requirements apply to these situations).

Plan Amendments

Plan sponsors may adopt the 2008 and later mortality tables by incorporating them by reference in their plan documents. However, if a plan document specifically refers to an annual applicable mortality table (e.g., the 2008 Applicable Mortality Table), the plan must be amended each year to reflect any later applicable mortality table and such amendments would have to satisfy the anti-cutback rules. Plan documents must be amended to reflect these changes by the last day of the first plan year beginning on or after January 1, 2009. However, operational compliance is required in the interim.

Next Steps

Plan sponsors should become familiar with the information contained in this *Compliance Bulletin* and discuss the impact on their plans with their enrolled actuary and legal counsel. Prudential Retirement's enrolled actuaries are well prepared to respond to your inquiries regarding the effect of this guidance on your plan.

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