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COMPLIANCE ADVISORY



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IRS extends temporary nondiscrimination relief for frozen defined benefit plans

On March 19, 2015, the Internal Revenue Service (IRS) issued [Notice 2015-28](#), which extends temporary nondiscrimination relief for certain “closed” defined benefit plans. This notice extends for one year the previous relief provided in [Notice 2014-5](#), which permits certain employers that sponsor a closed defined benefit plan and a defined contribution plan to demonstrate that the aggregated plans comply with nondiscrimination requirements on the basis of equivalent benefits.

Background

Many plan sponsors have amended their defined benefit plans to limit benefit accruals to some or all of the employees who participated in the plan on a specific date. A number of defined benefit plans have been closed to new employees. In conjunction with the closing of a defined benefit plan, the plan sponsor typically provides a defined contribution plan that is intended to replace benefit accruals under the defined benefit plan and provides new or greater contributions for new employees.

Nondiscrimination rules

The Internal Revenue Code (IRC) requires that a qualified plan cannot discriminate in favor of highly compensated employees (HCEs) with respect to benefits or contributions. The IRC contains special nondiscrimination rules that apply for determining whether an aggregation of plans that includes one or more defined benefit plans and one or more defined contribution plans satisfies the nondiscrimination rules.

Closed defined benefit plan issues

After a defined benefit plan has been closed to new employees, the plan may continue to satisfy the minimum coverage requirement without being aggregated with a defined contribution plan. However, over time, the minimum coverage test becomes more difficult for a closed defined benefit plan, as the proportion of plan participants who are HCEs increases.

This may occur for the following reasons:

- Non-highly compensated employees (NHCEs) have higher rates of turnover than HCEs; and
- Some of the NHCEs in the closed plan may become HCEs as they continue employment and receive salary increases.

If the closed defined benefit plan cannot pass the minimum coverage requirement on its own, it must be aggregated with another plan in order to satisfy the coverage requirement. If the closed defined benefit plan is aggregated with a defined contribution plan that covers the employer’s new employees to satisfy the coverage requirement, then it is also required to be aggregated with the defined contribution plan for purposes of satisfying the nondiscrimination requirements. Typically, the aggregated plans will fail to satisfy the nondiscrimination requirements unless they demonstrate nondiscrimination on the basis of equivalent benefits.

Aggregated plans must satisfy one of the following eligibility requirements in order to demonstrate compliance on the basis of equivalent benefits:

- The benefits must be primarily defined benefit in character;
- The plans consist of broadly available separate plans; or
- A minimum “aggregate allocation gateway” is satisfied.

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Notice 2014-5

Notice 2014-5 provides temporary relief to plan sponsors of certain closed defined benefit plans for the 2014 and 2015 plan years while the IRS considers possible changes to the nondiscrimination rules.

This relief permits an aggregated defined benefit and defined contribution plan to satisfy the nondiscrimination rules on the basis of equivalent benefits. The aggregated plans may demonstrate compliance on the basis of equivalent benefits for a plan year that begins before January 1, 2016, if the defined benefit plan was amended before December 13, 2013 to provide continued benefit accruals to plan participants and close the plan to new employees, and if the closed defined benefit plan:

- For the plan year beginning in 2013, was aggregated with a defined contribution plan and was either primarily defined benefit in character or consisted of broadly available separate plans; or
- The defined benefit plan passed nondiscrimination testing on its own for 2013.

During the period for which the temporary relief applies, the remaining provisions of the nondiscrimination rules continue to apply.

Extended relief in Notice 2015-28

Notice 2015-28 extends the relief provided in Notice 2014-5 for an additional year to plan years beginning before 2017 if the conditions of Notice 2014-5 are satisfied. During this extended period, the remaining provisions of the nondiscrimination rules continue to apply.

Next steps

Sponsors of closed defined benefit plans should read the information discussed in this publication. If they have questions concerning the impact of this guidance on their plan, they should contact their plan's enrolled actuary or legal counsel.

Compliance Advisory by Prudential Retirement

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