



IRS issues guidance on benefit limitation notice for defined benefit plans

Who’s affected

These developments affect sponsors of most qualified single-employer and multiple employer defined benefit plans. They do not affect multiemployer plans, governmental plans or church plans that do not elect to be covered by ERISA (“non-electing church plans”).

Background and summary

For plan years beginning on and after January 1, 2008, the Pension Protection Act of 2006 (PPA) and ERISA imposed new benefit limitations on plans that do not meet specific funding percentage levels. The plan administrator of a single-employer or multiple employer defined benefit plan must provide a written notice to participants and beneficiaries, generally within 30 days after the plan becomes subject to these benefit limitations.

In 2009, the IRS issued [final rules](#) for applying the new benefit limitation requirements.

The IRS recently issued [Notice 2012-46](#) to help plan administrators comply with the notice requirements of the final rules. This Notice supplements the final regulations and includes guidance on:

- General timing requirements;
- Which persons must receive the notice;
- Content requirements; and
- Acceptable methods for distribution.

Actions and next steps

The guidance discussed in this *Pension Analyst* affects plan administration. Plan sponsors should carefully read the information contained in this *Pension Analyst* and discuss the impact on their plans with their plan’s enrolled actuary and legal counsel.

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Under PPA, benefit limitations apply to:

- **Unpredictable contingent event benefits (UCEB).** A plan cannot pay unpredictable contingent event benefits (e.g., plant shutdown benefits) if the plan's adjusted funding target attainment percentage (AFTAP) is less than 60% or would be less than 60% as the result of paying such benefits.
- **Benefit accruals.** If a plan's AFTAP is less than 60%, the plan must freeze all benefit accruals as of the valuation date for the plan year.
- **Benefit increases.** A plan cannot adopt plan amendments that increase or improve benefits if the plan's AFTAP is less than 80% or would be less than 80% taking the amendment into account.
- **Prohibited payments.** A plan cannot pay prohibited payments (e.g., lump sum payments) if (1) the plan has an AFTAP of less than 60% or (2) the employer is in bankruptcy and the plan's AFTAP is less than 100%. If a plan's AFTAP is at least 60% but less than 80%, the plan cannot make a prohibited payment if the amount of payment exceeds the lesser of (1) 50% of the amount that could be paid in the optional form that includes the prohibited payment; or (2) the present value of the participant's maximum PBGC guarantee.

It is important to note that a "prohibited payment" is any:

- Payment exceeding the monthly amount payable under a single life annuity (plus any social security supplements) to a participant or beneficiary whose annuity starting date occurs during a period when the benefit restriction is in effect;
- Payment for the purchase of deferred annuities from an insurer to pay benefits; and
- Other payment specified by the IRS.

When any of the benefit limitations outlined above apply to a plan, the plan sponsor must notify participants and beneficiaries. Notice 2012-46 provides the following guidance regarding these notice requirements.

General timing requirements

The deadline for providing written notices to participants and beneficiaries is determined by the type of limitation that applies.

UCEB limits

A plan is subject to the limit on UCEBs on the date the plan's AFTAP is **certified** or presumed to be less than 60%. The notice must be provided no more than 30 days after the occurrence of the unpredictable contingent event. *For example: On March 18, 2013, a plan's AFTAP is certified to be less than 60% and the plan provides for an additional early retirement benefit upon the plant shutdown. The benefit limitation notice must be provided by April 17, 2013, which is the 30th day following the March 18, 2013 certification date, even if the plant has not shut down and is not expected to shut down.*

In addition, a notice must be provided on or before the latest of the following:

- If the employer is covered by the Worker Adjustment and Retraining Notification (WARN) Act and the related unpredictable contingent event (UCE) is an event for which a WARN Act notice must be provided, the date on which the WARN Act notice is provided;
- 60 days before the actual occurrence of the UCE; or
- 30 days after the date the employer makes a decision to cause the UCE to occur (e.g. a decision to shut down a plant).

Benefit accrual limits

A plan is subject to the limitation on benefit accruals on the date the AFTAP is certified to be less than 60%. The notice must be provided no more than 30 days after that date.

Prohibited payments restriction

A plan becomes subject to the prohibited payments restriction on the first day it is required to operate in accordance with the benefit limit. The notice must be provided within 30 days of the date the prohibited payment restriction applies. *For example: If a plan is certified to have an AFTAP of less than 80%, (but not less than 60%), the plan becomes subject to the limit on that date and a notice must be provided within 30 days after the date of certification. If the plan's AFTAP is later certified to be less than 60%, a second notice must be provided within 30 days after that date.*

If a plan allows participants to change the form of payment for their remaining benefits and the plan is subject to prohibited payments restriction, an additional notice must be provided when the limitation no longer applies. In this situation, the notice must be provided within 30 days after the date that the restriction no longer applies.

Interaction with 204(h) notices

[ERISA section 204\(h\)](#) requires plan administrators to notify participants who are adversely affected by a plan amendment that results in a significant reduction in the rate of future benefit accruals. Notice 2012-46 provides guidance on the interaction of the section 204(h) notice requirement with the benefit limitation notice.

If a plan amendment significantly reduces a participant's rate of future benefit accruals, a section 204(h) notice must be provided, but a benefit limitation notice is not required. However, a benefit limitation notice is required if the plan is unable to pay UCEBs or prohibited payments after benefit accruals have ceased. In addition, if the plan that ceases benefit accruals because the AFTAP is less than 60% is later amended to permanently freeze benefit accruals or significantly reduce the rate of future benefit accruals, the plan must provide a section 204(h) notice.

For example: Plan's AFTAP is certified to be less than 60% on May 15, 2013. Plan is required to cease all benefit accruals as of May 15, 2013 and a benefit limitation notice must be provided within 30 days. On October 1, 2013, plan is amended to freeze the plan permanently as of January 1, 2014. A benefit limitation notice is not required. However, a section 204(h) notice must be given to affected individuals.

Who must receive the notice

A notice must be provided to each participant covered under the plan and each beneficiary entitled to benefits on the first date the plan becomes subject to a limitation. A limitation applies or could apply to a participant or beneficiary only if the participant or beneficiary could be adversely affected by the limitation.

UCEB limits

The UCEB limit applies to any participant or beneficiary who on the date the limit applies could be entitled to those benefits, currently or at a future date, in the event the contingency on which benefits are based occurs.

For example: Plan provides for an UCEB benefit as an early retirement subsidy due to involuntary termination in connection with a plan shutdown for participants whose employment ends after age 55 but before normal retirement age. A plan's AFTAP is certified on February 1, 2013 to be less than 60%. The plan cannot pay UCEBs. A notice must be provided to each participant who is employed at that plant. However, employees who have reached normal retirement age do not have to receive the notice since they will never be eligible for the early retirement subsidy. In addition, a notice would not have to be provided to participants at a different location where there were no UCEBs for a shutdown.

Benefit accrual limits

The limit applies to any participant who is accruing a benefit under the plan on the date the limitation applies. A notice must be provided to each participant but does not have to be provided to former employees or beneficiaries who do not accrue benefits under the plan.

Prohibited payments restriction

If the plan is subject to the prohibited payments restriction, the restriction applies to a participant or beneficiary on the date the limit applies to the plan and who could be eligible to elect to receive a prohibited payment under the plan, currently or at a future date, if the limit did not apply.

The notice does not have to be provided:

- To a participant who is receiving pension payments and would not be eligible to elect a prohibited payment even if the plan were not subject to the limitation.
- If the plan does not offer forms of payment that are prohibited payments.

However, a notice must be provided to any participant or beneficiary who is eligible to elect a prohibited payment after the date the restriction applies and who separated from service after reaching any age or service condition for eligibility to elect that form of payment.

Special rule for limited restriction period

The guidance provides a special rule when the limitation ends before the notice deadline. In this situation, a notice must be provided only to those participants and beneficiaries who were affected by the benefit limitation during the period after the plan became subject to the benefit limit and before it ceased to be subject to the limit. A notice does not have to be provided if no participant or beneficiary was affected by the benefit limitation during that period.

Content requirements

A notice must contain the following information:

- General rule.
 - The name of the plan, the plan's employer identification number (EIN), and the plan number.
 - A general description of the limitation. For example, a description of the benefits not permitted to be paid in the case of unpredictable contingent event or prohibited payments or that benefit accruals have ceased when a plan has frozen benefit accruals.
 - A statement that the limitation applies because of the level of the plan's AFTAP ("funded percentage"), including the specific percentage that constitutes the AFTAP. The notice must also state whether the AFTAP is the result of a certification issued by the plan's enrolled actuary or is the result of the application of a presumption under ERISA.
 - If the limitation is due to the employer's bankruptcy, the notice must state that the limit applies because of the relevant legal process (under which the plan sponsor is a debtor in a case under title 11, United States Code, or similar Federal or State law) and because the plan's AFTAP has not been certified to be at least 100%.
 - If the limitation is due to an unpredictable contingent event, the notice must describe the event in sufficient detail to demonstrate the difference between the plan's benefits that would be payable if the limitation had not applied and those that are payable after application of the limitation.
 - If prohibited payments are limited, the notice must describe the prohibited payments in sufficient detail to demonstrate the difference between the plan's benefits that would be payable if the limit did not apply and those that are payable after application of the limit.
 - A description of the conditions under which the limit will no longer apply and a description of plan provisions that will apply after the limitations cease.
 - The effective date of the limitation.
 - The class of participants or beneficiaries affected.
 - The name, address, and telephone number of the plan administrator, trustee, or other contact person from whom more information may be obtained.
- For plans that permit new annuity starting dates, the notice must provide the following information:
 - The name of the plan, the plan's employer identification number (EIN), and the plan number.
 - A statement that the limit no longer applies.

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- A statement that the participant or beneficiary is eligible to elect the form of payment that was prohibited, including any deadlines and procedures that apply.
- The name, address and telephone number of the plan administrator, trustee, or other contact person to obtain more information.
- The notice must be written in a manner calculated to be understood by the average plan participant. The notice must be written in a manner so that the participant or beneficiary will understand the significance of the required information relating to the benefit limitation.
- The notice may include additional information that is necessary or helpful for participants or beneficiaries to understand, provided it does not mislead or misinform recipients.
- A single combined notice can be provided if the plan is subject to more than one limitation.

Distribution methods

The notice must be in writing and may be furnished in any paper or electronic form to the extent the form is reasonably accessible to participants and beneficiaries required to receive the notice.

If the notice is distributed electronically, the plan may use the electronic disclosure methods permitted by the

- Department of Labor (DOL); and
- IRS for providing [ERISA 204\(h\) notices](#).

Civil penalties

The Department of Labor (DOL) may assess civil penalties, not to exceed \$1,000 per day, for each violation by any person for failure to provide participants and beneficiaries with the benefit restriction notice.

Effective dates and next steps

This guidance is effective November 1, 2012. However, plan administrators may follow these rules before that date or may follow a reasonable interpretation of ERISA section 101(j).

If Prudential Retirement provides actuarial services for your plan and if your plan is subject to benefit limitations, we will prepare a draft of the notice for review and approval by you and your legal counsel. If Prudential Retirement does not provide actuarial services, you should contact your plan's enrolled actuary or legal counsel regarding the preparation of the notice.

Pension Analyst by Prudential Retirement

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