



IRS provides temporary relief for frozen defined benefit plans

On December 13, 2013, the Internal Revenue Service (IRS) issued [Notice 2014-5](#), which provides temporary nondiscrimination relief for certain “closed” defined benefit pension plans. This notice 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 for the 2014 and 2015 plan years.

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 plan is qualified only if the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees (HCEs). The nondiscrimination rules contain special rules that apply for purposes of determining whether an aggregation of plans that includes one or more defined benefit plans and one or more defined contribution plans satisfies the nondiscrimination requirements.

Closed defined benefit plan issues

In the early years 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 several reasons, such as the:

- Tendency of non-highly compensated employees (NHCEs) to have higher rates of turnover than HCEs; and
- Potential for some of the NHCEs in the closed plan to 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 rules](#). 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.

The notice recognizes that there are situations when a plan sponsor cannot satisfy the nondiscrimination rules. In that case, a plan sponsor generally has three choices:

- Reduce the proportion of HCEs in the closed defined benefit plan by either opening it up to some new NHCEs or by ceasing participation by some HCEs;
- Change the contributions under the defined contribution plan so that it satisfies one of the conditions for testing on the basis of equivalent benefits; or
- Cease all benefit accruals under the defined benefit plan.

Temporary relief

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 even if the plans do not satisfy any of the [eligibility](#) conditions described above. 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.

Request for comments

The IRS also requested comments on possible permanent changes to the nondiscrimination rules. These comments must be submitted by February 28, 2014.

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 consult their plan's enrolled actuary or legal counsel.

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