

IRS Updates Rules for Defined Benefit Plans

WHO'S AFFECTED These rules provide administrative and funding guidance that affects defined benefit plans only. Governmental plans and plans sponsored by churches that elect not to be covered under ERISA ("non-electing church plans") are subject to only some of these rules.

BACKGROUND AND SUMMARY At the end of 2001, the IRS published two separate revenue rulings, focusing on defined benefit plan issues:

- IRS Revenue Ruling 2001-51 provides guidance regarding the increased maximum allowable benefit, as provided under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). It also confirms that plans may either maintain the benefit limits in effect before the enactment of EGTRRA or adopt the increased limits.
- IRS Revenue Ruling 2001-62 updates the mortality table that must be used in figuring both the minimum "present value" of lump sum benefits and the actuarial adjustment to the maximum allowable benefit. All defined benefit plans that rely on these code sections *must* adopt this new table.

ACTION AND NEXT STEPS Plan sponsors should review this publication to identify the items that may apply to their plans and participants.

All defined benefit plans must adopt the new mortality table for certain benefit determinations. In most cases, plan sponsors will have to adopt these amendments by December 31, 2002, although some later amendment deadlines are possible.

Some plan sponsors may also have to or want to adopt additional EGTRRA plan amendments to ensure that the appropriate maximum benefit limit is reflected in their plans. The general deadline for adopting this amendment is the last day of the 2002 plan year, but an extended amendment deadline may apply.

*Republished December 2004 to reflect Prudential Financial's acquisition of CIGNA's retirement business.

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IRS Revenue Ruling 2001-51

Overview

As reported in the June 2001, *Pension Analyst* “[The ‘Economic Growth and Tax Relief Act of 2001’ Makes Significant Changes to Retirement Plans and IRAs](#),” EGTRRA increased the maximum annual benefit under a defined benefit plan and the annual addition limits for defined contribution plans, for 2002 and later years. In addition, effective for limitation years beginning in 2002, multiemployer defined benefit plans are not subject to the 100% compensation limit.

After the enactment of EGTRRA, the IRS published sample amendments for plans to use when adopting EGTRRA changes. An October, 2001, *Pension Analyst*, “[IRS Publishes Model Amendments for EGTRRA](#),” describes these sample amendments.

This revenue ruling provides additional guidance on applying the new annual defined benefit limit of \$160,000 (was \$140,000 in 2001) for limitation years ending in 2002 and later. It also discusses what benefit adjustments are required for payments starting at ages earlier than age 62 and starting later than age 65, adjustments to benefits for payments other than a straight life annuity, and certain plan administrative and funding issues.

Plans Affected

All defined benefit plans have the *option* to adopt the EGTRRA changes or retain the old 2001 limits.

The rules for *adjusting* the benefit limits for governmental plans, non-electing church plans, and plans sponsored by other tax exempt organizations (e.g., a plan sponsored by a hospital) have not changed under EGTRRA. In fact, EGTRRA’s new rules for adjusting for age have applied to these

plans for several years. As a result, the only change for these types of plans is the increase in the dollar limit, from \$140,000 to \$160,000.

Effective Date

The increased limits apply to plan participants who have a benefit under the plan on or after the *first day of the limitation year that ends in 2002*. For a plan with a calendar limitation year, the new limit would be effective for employees who have a benefit on or after January 1, 2002. However, if a plan has a limitation year that begins on October 1 and ends on September 30, the new limit would be effective October 1, 2001, since that is the first day of the limitation year ending in 2002.

Participants Affected

A plan may be amended to provide the EGTRRA increases only to current employees who are participants in the plan as of the effective date described above. On the other hand, the plan may provide that participants who had terminated employment before the effective date and who have an accrued benefit under the plan as of *that* date will be entitled to the increase. *For example, if on January 1, 2002, a retired participant is receiving a monthly annuity that had been limited by the pre-EGTRRA benefit limit, and the plan has a calendar limitation year, benefit payments starting on January 1, 2002, may be increased to the new limit.*

Required Plan Amendments

If a plan document specifically defines the pre-EGTRRA limits, and the plan sponsor does not want to apply the new limits, no plan amendment is needed.

If a plan document specifically defines the old limits, and the plan sponsor wants to apply the new limits, the plan must be amended to state the new limits. In general, this amendment must be adopted by the last day of the 2002 plan year. However, if the plan has an extended GUST amendment deadline under the special master, prototype, or volume submitter plan rules, the deadline for this amendment is extended to the GUST amendment deadline.

If a plan document simply references Internal Revenue Code section 415 to describe the maximum benefit limits, the new limits will automatically apply as of the first day of first limitation year ending in 2002. No amendment is needed to apply the new limits. However, if the plan sponsor does not want the new limits to “pop up,” a plan amendment is needed. To avoid this unintentional increase and maintain the old limits, the plan must be amended before the first day of the limitation year that ends in the 2002 calendar year. This meant that a plan with a limitation year beginning on October 1 should have been amended by September 30, 2001, to retain the old limits and avoid the automatic increase. The Job Creation and Worker Assistance Act (JCWAA), signed into law in March 2002, provided relief to some plans that referenced the Code section in the plan document. It relaxed the protected benefit rules to allow plan sponsors to amend their plans and adopt the old limits after the usual amendment deadline. To take advantage of the relaxed rule, the amendment had to be adopted by June 30, 2002, even if the plan’s first limitation year ending in 2002, ended before that date. An April 2002, *Pension Analyst*, "[Economic Stimulus Bill Provides Funding Relief for Defined Benefit Plans and Technical Corrections to EGTRRA](#)", discussed this change.

Plan Administrative Issues

This ruling also provides guidance regarding early or late retirement adjustments to the new benefit limits and adjustments due to payment forms other than a straight life annuity. In general, the new limits will provide for a larger adjusted maximum benefit due to early or late retirement than was available under pre-EGTRRA rules.

For plans that have a normal retirement age lower than age 65, a participant's benefit at age 65 could be greater than EGTRRA's maximum allowable benefit at age 65. This could happen if the plan provides an actuarially increased benefit due to late retirement and that increased benefit exceeds the maximum allowable benefit at that age. In this situation, the plan may also need to be amended to provide for payments to begin at normal retirement age even if the participant is still working or to provide the participant with a suspension of benefits notice.

As long as the plan adopts "good faith" EGTRRA amendments in a timely manner, it will retain its pre-EGTRRA nondiscrimination testing results. For example, if the plan was a safe harbor plan and the plan is amended in accordance with the rules discussed above, it will remain a safe harbor plan. If the plan is amended at a later date or the amendment reflects a select group, additional nondiscrimination testing may be required.

Governmental plans and non-electing church plans continue to be subject to the special nondiscrimination rules and exempt from the protected benefit rules.

Plan Funding Issues

For purposes of determining the minimum required cash contribution under ERISA, the maximum deductible cash contribution for qualified benefit plans, and for figuring a participant's maximum allowable benefit, plans must ignore EGTRRA's "sunset provision." Under the "sunset provision," the increased limits will expire after December 31, 2010, unless legislation is enacted to make them permanent.

Plans that adopt the EGTRRA limits may have to make increased contributions to the plan. The dollar impact on plans will vary depending on the number of participants currently and potentially benefiting from the increased limits and the plan's funding method rules. Your plan's Enrolled Actuary should be able to help you assess the cost impact on your plan.

IRS Revenue Ruling 2001-62

Overview

The IRS has updated the "applicable mortality table" *for determining participants' minimum lump sum benefits as well as their maximum allowable plan benefit.* This new table is based on the prevailing commissioners' standard table used by the state insurance commissioners to determine the sufficiency of insurance company group annuity reserves.

The new table is the 1994 Group Annuity Reserving Table (94 GAR), which is adjusted to a unisex basis and projected to year 2002. The table replaces the 1983 unisex Group Annuity Mortality table, commonly referred to as the “GATT” mortality table.

Plans Affected

All defined benefit plans *must* adopt the new mortality table.

Governmental plans and non-electing church plans must be amended since they are subject to the maximum benefit limits. These plans do not have to amend their minimum lump sum provisions to use the new table.

Effective Date

Regardless of when the plan is amended (see [Plan Amendment Deadline](#), below), the new mortality table *must be used* for benefit payments with benefit starting dates occurring on or after December 31, 2002. The IRS refers to this date as the plan’s “94 GAR Effective Date.”

An earlier 94 GAR Effective Date is permitted as long as the date selected is:

- On or after January 1, 2002;
- Before January 1, 2003; and
- A single 94 GAR Effective Date, that is used for both minimum lump sum and maximum benefit determinations.

Generally, the 94 GAR Effective Date and the date of the amendment will occur in the same plan year. *For example, a plan sponsor that has a plan year beginning on October 1 could elect any date between January 1, 2002, and September 30, 2002, as the 94 GAR Effective Date, as long as the plan amendment is adopted by September 30, 2002. Otherwise, it must choose any date from October 1, 2002, through December 31, 2002, as the 94 GAR Effective Date and adopt the plan amendment by September 30, 2003.*

It is permissible for the amendment to be adopted in the plan year preceding the year in which the 94 GAR Effective Date occurs. *For example, a plan sponsor that has a plan year beginning on October 1, could choose to amend his plan before October 1, 2002 and select a 94 GAR Effective Date occurring between October 1, 2002 and December 31, 2002.*

Plan Amendment Deadline

Plan sponsors must amend their plans no later than the last day of the plan year that includes the 94 GAR Effective Date. This means that plans with calendar plan years must be amended by December 31, 2002. Plans with a non-calendar plan year that have a 94 GAR Effective Date of December 31, 2002, must be amended by the last day of the first plan year beginning in 2002.

If the plan is not amended by the end of the 2002 plan year containing the 94 GAR Effective Date, the amendment will not be considered “timely.” If the plan is not amended in time, the plan will not be able to take advantage of any relief associated with correcting errors within the timeframe allowed under the EGTRRA remedial amendment period, which is the last day of the plan year that begins in 2005.

Plan Administrative Issues

Although the IRS allows a 94 GAR Effective Date to be different from the date of amendment, some pension professionals recommend that both dates be the same. The IRS states that it will ignore the protected benefit rules (“anti-cutback rules”) for any benefit payments occurring after the amendment date, but not before. This means if the 94 GAR Effective Date occurs before the date of amendment, benefit payments with starting dates occurring between the 94 GAR Effective Date and the amendment date cannot be less than what the old mortality table would have produced. However, because the new table *must* be used for benefit payments with starting dates occurring on or after the plan’s 94 GAR Effective Date, adjustments have to be made to future payments due to the excess payments made between the 94 GAR Effective Date and the amendment date.

The ruling does not mention ERISA 204(h) notices. The IRS has informally stated that no Section 204(h) notices are required, because this change is not a *significant* reduction in benefit. The new table will most likely produce a slightly larger minimum lump sum payment and may have little effect on the adjusted maximum benefit.

The IRS will automatically review plan documents in conjunction with this revenue ruling for plans requesting a determination letter *on or after the last day of the plan year* that contains the 94 GAR Effective Date. Plans requesting a determination letter *before the end of the plan year* that contains the 94 GAR Effective Date will have their documents reviewed for compliance if the amendment is submitted with the request.

IRS Model Amendments

The IRS has provided two model amendments that may be used for adopting the new mortality table. These amendments may be changed to match other language contained in the plan document, but only minor changes are acceptable.

A plan sponsor may adopt a model amendment as an addendum to the existing plan document. Adopting a model amendment will not cause a pre-approved master, prototype, or volume submitter plan to be treated as an individually designed plan nor will it adversely affect the plan sponsor’s reliance on a favorable determination or advisory letter.

Cost to the Plan

The change to the new table may produce slightly larger minimum lump sum benefits. Maximum benefit amounts could remain virtually unchanged or slightly decrease. However, a plan could be more than minimally affected from a funding perspective. The plan’s Enrolled Actuary is available to help you assess the cost impact (if any) on your plan.

Next Steps

Prudential Retirement will be providing the model amendments related to the change in the mortality table to all defined benefit plan sponsors who use Prudential’s document services. Plan sponsors who do not have document services with Prudential need to discuss the implementation of this amendment with their document provider. Sponsors of calendar plan years must amend

their plans no later than December 31, 2002. In the meantime, if you have any questions about any of the information contained in these revenue rulings, please contact your Prudential Retirement representative or the plan's Enrolled Actuary.

Pension Analyst by Prudential Retirement

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