IRS Provides Guidance on PPA Employer Deduction Limits

The Pension Protection Act of 2006 (PPA) increased the deduction limits for employer contributions made to:

- Single employer defined benefit plans;
- Multiemployer defined benefit plans; and
- Combined (defined benefit and defined contribution) plans.

On March 13, 2007, the IRS published Notice 2007-28, providing guidance regarding the new limits that are effective for 2006 and 2007.

While Prudential Retirement cannot provide tax advice to plan sponsors, we do want to make you aware of this additional PPA guidance. Naturally, plan sponsors should consult their tax advisors to determine how these rules apply to their plans.

New PPA Deduction Rules

For tax years beginning in 2006 and 2007, the maximum deductible contribution for a *single employer defined benefit plan* is 150% of the plan’s current liability, minus the value of plan assets.

For tax years beginning in 2006 and later, the maximum deductible contribution for a *multiemployer defined benefit plan* is 140% of the plan’s current liability, minus the value of plan assets.

When an employer sponsors *both a defined contribution plan and a defined benefit plan covering one or more of the same employees* (overlapping participation), the law provides that a “combined plan limit” applies *in addition to* the standard defined contribution and defined benefit plan limits. In this situation, the maximum deductible contribution is the greater of:

- 25% of compensation paid or accrued during the plan years to participants in the combined plans; or
- The contribution necessary to meet the minimum funding requirements, but not less than the amount of the defined benefit plan’s unfunded current liability.

Effective for contributions made for tax years beginning in 2006 and 2007, this combined plan limit does not take into account:

- Defined contribution plan contributions that total 6% or less of participant compensation; and
- Contributions made to multiemployer plans.
IRS Guidance

In Notice 2007-28, the IRS explains how to apply these new rules when a plan’s plan year is not the same as the employer’s tax year. Generally, in these situations, the employer has three options for determining its deductible contribution limit. The employer may use:

1. The deductible limit for the plan year beginning in the tax year;
2. The deductible limit for the plan year ending in the tax year; or
3. A weighted average of alternatives 1 and 2, above.

Regardless of the plan year used, the deductible limit calculation must reflect the law in effect for the tax year for which the deduction is being taken. For example, if an employer has a non-calendar tax year that began in 2005 and ended in 2006, and a calendar plan year, the deductible limit calculation for the 2005 tax year cannot reflect the PPA rules, even if the calculation is based on the plan year beginning January 1, 2006.

Combined Plan Limit

With respect to the combined plan limit, the IRS Notice explains how only certain contributions to a 401(k) plan must be taken into account.

If an employer sponsors both a defined benefit plan and a deferral-only 401(k) plan with overlapping participation, but no other defined contribution plans with overlapping participation, the combined plan limit will not apply.

If an employer sponsors defined benefit and defined contribution plans with overlapping participation and employer contributions to the defined contribution plans (other than elective deferrals) exceed 6% of total compensation for participants in those plans, the combined plan limit will apply. However, only the employer contributions exceeding 6% of compensation are taken into account when applying that limit.

If an employer sponsors defined benefit and defined contribution plans with overlapping participation, but employer contributions to the defined contribution plans (other than elective deferrals) do not exceed 6% of total compensation for participants in the defined contribution plans, the guidance provided by this Notice appears to be inconsistent with the new law. The law appears to indicate that the combined plan limit will not apply in these circumstances. However, Notice 2007-28 clearly indicates that the combined plan limit will still apply, but to just the defined benefit plan contributions. If the IRS maintains the position taken in the Notice, the result could be a reduction in contributions made to the defined benefit plan, which seems inconsistent with the purposes of PPA.

A number of industry groups have asked the IRS to reconsider the guidance provided in Notice 2007-28. Ideally, the guidance would be revised to be more consistent with the general interpretation of the actual PPA provisions. Alternatively, these groups have asked the IRS to provide transition relief for plan sponsors that made 2006 contributions based on a reasonable interpretation of the PPA provisions before the publication of this Notice. Naturally, if there are further developments in this area, we will keep you informed. If you are concerned about the deductibility of contributions made to your plans for 2006, we suggest that you consult your tax advisor.