

Part III - Administrative, Procedural, and Miscellaneous

Description of Benefits Permitted to be Provided in Qualified Defined Benefit Plans

Notice 2007-14

I. PURPOSE

The Treasury Department and the Internal Revenue Service are considering guidance under §§ 401(a) and 411 of the Internal Revenue Code to provide clarification regarding the types of benefits that are permitted to be provided in a qualified defined benefit plan. The guidance under consideration would initially be issued in the form of proposed regulations. This notice describes the guidance under consideration and requests comments on the issues raised in Part III of this notice.

II. BACKGROUND

Section 401(a) provides rules for qualified pension plans, profit-sharing plans, and stock bonus plans. Section 1.401-1(a)(2) of the Income Tax Regulations provides that a qualified pension plan (i.e., a qualified defined benefit plan or money purchase pension plan) is a definite written program and arrangement which is communicated to the employees and which is established and maintained by an employer to provide for the livelihood of the employees or their beneficiaries after the retirement of such employees through the payment of benefits. Under § 1.401-1(b)(1)(i), a qualified

pension plan must be established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits for employees over a period of years, usually for life, after retirement.¹

Retirement benefits in a qualified defined benefit plan usually are measured by, and based on, factors such as years of service and compensation. A qualified defined benefit plan (or other qualified pension plan) also may provide certain non-retirement benefits, such as disability benefits and incidental death benefits. Under § 1.401-1(b)(1)(i), a qualified pension plan is not permitted to provide for the payment of benefits not customarily included in a pension plan, such as layoff benefits.²

Section 411(d)(6)(A) generally provides that a plan is treated as not satisfying the requirements of § 411 if the accrued benefit of a participant is decreased by a plan amendment. Section 411(d)(6)(B) provides that a plan amendment that has the effect of eliminating or reducing an early retirement benefit or a retirement-type subsidy, or eliminating an optional form of benefit, with respect to benefits attributable to service before the amendment is treated as impermissibly reducing accrued benefits. For a retirement-type subsidy, this protection applies only with respect to an employee who satisfies the preamendment conditions for the subsidy (either before or after the amendment).

Not all types of benefits permitted to be provided in a qualified defined benefit plan are protected from cutback under § 411(d)(6). In this respect, the 1984 Senate

¹ The regulations under § 401(a) provide separate rules for profit-sharing plans and stock bonus plans. See § 1.401-1(a)(2) and (b)(1)(ii) and (iii).

² Section 1.401-1(b)(1)(i) specifies that other benefits not customarily included in a pension plan include benefits for sickness, accident, hospitalization, or medical expenses (except medical benefits described in

Finance Committee Report regarding section 301(a) of the Retirement Equity Act of 1984, Public Law 98-397 (98 Stat. 1426) (REA), which extended § 411(d)(6) anti-cutback protection to optional forms of benefit, early retirement benefits, and retirement-type subsidies, provides, in part:

The bill provides that the term "retirement-type subsidy" is to be defined by Treasury regulations. The committee intends that under these regulations, a subsidy that continues after retirement is generally to be considered a retirement-type subsidy. The committee expects, however, that a qualified disability benefit, a medical benefit, a social security supplement, a death benefit (including life insurance), or a plant shutdown benefit (that does not continue after retirement age) will not be considered a retirement-type subsidy. The committee expects that Treasury regulations will prevent the recharacterization of retirement-type benefits as benefits that are not protected by the provision.

S. Rep. No. 98-575, at 30.

Sections 1.411(d)-3 and 1.411(d)-4, which were amended on August 12, 2005 (70 FR 47109), provide rules relating to § 411(d)(6) protected benefits.

Section 1.411(d)-4, Q&A-1(d), specifies that certain benefits, including ancillary benefits, are not protected from reduction or elimination under § 411(d)(6)(B). Section 1.411(d)-3 also includes rules relating to ancillary benefits. Section 1.411(d)-3(b)(3)(i) provides that § 411(d)(6) does not provide protection for benefits that are ancillary benefits, other rights and features, or any other benefits that are not described in § 411(d)(6).

§ 401(h) as defined in § 1.401-14(a)).

Section 1.411(d)-3(g)(2) defines the term “ancillary benefit” as:

(1) a social security supplement under a defined benefit plan (other than a QSUPP as defined in § 1.401(a)(4)-12));

(2) a benefit payable under a defined benefit plan in the event of disability (to the extent that the benefit exceeds the benefit otherwise payable), but only if the total benefit payable in the event of disability does not exceed the maximum qualified disability benefit, as defined in § 411(a)(9);

(3) a life insurance benefit;

(4) a medical benefit described in § 401(h);

(5) a death benefit under a defined benefit plan other than a death benefit which is part of an optional form of benefit; or

(6) a plant shutdown benefit or other similar benefit in a defined benefit plan that does not continue past retirement age and does not affect the payment of the accrued benefit, but only to the extent that such plant shutdown benefit or other similar benefit is permitted in a qualified pension plan.

Section 1.411(d)-3(g) defines other key terms relating to the anti-cutback rules, including “retirement-type subsidy” and “retirement-type benefit.” Section 1.411(d)-3(g)(6)(iv) defines the term “retirement-type subsidy” as the excess, if any, of the actuarial present value of a retirement-type benefit, over the actuarial present value of the accrued benefit commencing at normal retirement age or at actual commencement date, if later, with both such actuarial present values determined as of the date the retirement-type benefit commences. Section 1.411(d)-3(g)(6)(iii) defines the term “retirement-type benefit” as the payment of a distribution alternative with respect to an

accrued benefit or the payment of any other benefit under a defined benefit plan (including a QSUPP as defined in § 1.401(a)(4)-12) that is permitted to be in a qualified pension plan, continues after retirement, and is not an ancillary benefit.

Under § 1.411(d)-4, Q&A-6, a plan may limit the availability of § 411(d)(6) protected benefits to employees who meet objective conditions that are ascertainable, specifically set forth in the plan, and not subject to employer discretion.³ Q&A-6 provides examples of permissible objective conditions. Section 1.411(d)-4, Q&A-7 generally provides that a plan is not permitted to be amended to add objective conditions with respect to a § 411(d)(6) protected benefit that has already accrued. However, a plan amendment does not violate § 411(d)(6) to the extent that it applies to benefits that accrue after the amendment. Therefore, an amendment adding objective conditions to a § 411(d)(6) protected benefit is permitted with respect to benefits that accrue after the applicable amendment date.⁴

Section 411(a) provides that a qualified plan must provide that an employee's right to his normal retirement benefit is nonforfeitable upon the attainment of normal retirement age, and also provides vesting requirements with respect to an employee's accrued benefit. Under § 411(a)(9), the term "normal retirement benefit" is defined as the greater of the early retirement benefit under the plan or the benefit under the plan commencing at normal retirement age. Section 411(b)(1) provides anti-backloading

³ A plan provision that permits an employer to deny a participant a § 411(d)(6) protected benefit for which the participant is otherwise eligible through the exercise of discretion violates the requirements of § 411(d)(6). See § 1.411(d)-4, Q&A-4. Similarly, pursuant to § 1.411(d)-4, Q&A-6(b), a plan cannot condition the availability of § 411(d)(6) protected benefits on objective conditions that are within the employer's discretion.

⁴ The term applicable amendment date means the later of the effective date of a plan amendment or the date the amendment is adopted. See §1.411(d)-3(g)(4).

rules governing the accrual of benefits under a defined benefit plan, to ensure that the minimum vesting rules of § 411(a) are not circumvented through a plan formula under which accruals are inappropriately deferred.

Section 905(b) of the Pension Protection Act of 2006 (“PPA ’06), enacted on August 17, 2006, added § 401(a)(36), which provides that, for plan years beginning after December 31, 2006, a pension plan will not fail to qualify under § 401(a) solely because the plan provides that a distribution may be made to an employee who has attained age 62 and who is not separated from employment at the time of the distribution.

III. GUIDANCE UNDER CONSIDERATION

Treasury and the Service have become concerned that certain qualified defined benefit plans may include nontraditional benefits that are not subject to the protections of § 411 and other qualification rules of § 401(a). Examples of the types of benefits for which this concern arises include: (1) benefits that are payable only upon the involuntary termination of an employee or in other limited circumstances that are unrelated to retirement; and (2) benefits that could exceed the amount of the accrued benefit payable under the plan. If these benefits are contingent on future events that are not reasonably and reliably predictable on an actuarial basis, it is difficult to determine compliance with the incidental benefit requirements.⁵ Moreover, there may be a risk that, in effect, if the contingent event on which the benefit is conditioned

⁵ In the case of benefits which are contingent on events that are reasonably and reliably predictable on an actuarial basis (e.g., death), the probability that those contingencies will occur is taken into account in determining whether retirement benefits are the primary benefit under the plan (i.e., whether nonretirement benefits provided under the plan are merely incidental).

occurs, such a benefit could become a substantial or even the primary benefit that plan participants expect to receive. Such benefits also may not be the types of benefits that have been customarily included in qualified pension plans. Benefits payable only upon an employee's involuntary separation from service also raise questions regarding whether the availability of the benefits is based on conditions that are within the employer's control, and whether such benefits circumvent the vesting and anti-backloading protections of § 411, as well as the definitely determinable benefits requirement of § 401(a). In addition, such benefits may not be among the type of benefits that are intended to receive the tax benefits generally applicable to qualified plan benefits.

Treasury and the Service believe that guidance to clarify the application of the requirements of §§ 401(a) and 411 to these types of benefits may be appropriate in light of the regulations under § 411(d)(6) that were issued in 2005. The § 1.411(d)-3 definitions of an ancillary benefit, a retirement-type benefit, and a retirement-type subsidy depend, in part, on whether a benefit is permitted to be provided in a qualified defined benefit plan. However, current guidance does not directly address whether certain benefits, such as benefits which are similar to plant shutdown benefits that do not continue after retirement or benefits payable solely upon involuntary separation, are permitted to be provided in a qualified pension plan. Thus, Treasury and the Service are considering whether to propose guidance that would clarify the types of benefits that are permitted to be provided in qualified defined benefit plans.

The guidance under consideration may include the following:

A. Permitted benefits. The guidance might provide that, in addition to the payment of retirement-type benefits (including retirement-type subsidies), the only benefit payments that are permitted to be provided under a qualified defined benefit plan are the payment of the ancillary benefits specifically identified in §1.411(d)-3(g)(2).

B. Plant shutdown benefits and similar ancillary benefits. With respect to a plant shutdown benefit, the guidance might require that the benefit be payable as a result of an objectively defined plant shutdown event, such as an event that requires notice under the Worker Adjustment and Retraining Notification Act of 1988 (WARN), 29 U.S.C. section 2102. For benefits that are similar to plant shutdown benefits and that do not continue past retirement age, the guidance might set forth the extent to which there are any such “similar benefits,” as described in § 1.411(d)-3(g)(2)(vi), that are permitted to be provided in a qualified defined benefit plan.

The guidance also might clarify that an ancillary plant shutdown benefit, as described in § 1.411(d)-3(g)(2)(vi), is permitted to be provided in a qualified defined benefit plan only if the amount payable in any year prior to retirement does not exceed the amount payable annually under the participant’s accrued benefit expressed as an annual benefit commencing at normal retirement age and that the benefit may not be paid in a shorter or longer alternative form of payment. Under such a rule, for example, if a plan participant who is below the plan’s normal retirement age of 65 had an accrued benefit payable as a life annuity at age 65 of \$1,000 a month, the plan would be permitted to provide an ancillary plant shutdown benefit payable as a temporary annuity in an amount up to \$1,000 a month. In such a case, the ancillary plant shutdown benefit would be paid to the plan participant up until the annuity starting date for payment of the

participant's accrued benefit under the plan (e.g., age 65 or some earlier age when the participant commences payment of the participant's accrued benefit in the form of a qualified joint and survivor annuity or elects an alternative optional form). This illustration of an ancillary plant shutdown benefit is different from a subsidized early retirement benefit payable on the occurrence of a plant shutdown.⁶

C. Contingent accruals and early retirement benefits. The guidance might also provide that, except for the payment of the accrued benefit in an optional form, a retirement-type benefit (and thus a retirement-type subsidy) is permitted to be provided in a qualified defined benefit plan only if the amount of the benefit is no greater than the unreduced accrued benefit provided under the plan. The guidance might also clarify the extent to which additional accruals are permitted, taking into account the backloading and vesting rules under § 411, if those accruals arise by reason of an event other than attainment of a specified age, performance of service, receipt or derivation of compensation, or the occurrence of death or disability (e.g., if those additional accruals arise upon involuntary termination of employment). The guidance also might clarify the extent to which early retirement benefits (i.e., benefits payable before normal retirement age, but after severance from employment, that are not ancillary benefits) payable as a result of a plant shutdown event, an involuntary termination of employment, or another event similarly under the control of the employer are permitted to be provided in a qualified defined benefit plan.

⁶ An example of a subsidized early retirement benefit is the unreduced early retirement benefit described in *Bellas v. CBS, Inc.*, 221 F.3d 517 (3d. Cir. 2000), cert. denied, 531 U.S. 1104 (2001) (holding that an early retirement benefit that is more valuable than an actuarially reduced normal retirement benefit and that is payable on occurrence of an unpredictable contingent event is a retirement-type subsidy, and

IV. EFFECTIVE DATE

It is anticipated that the guidance under consideration in this notice would be prospective. No implication is intended that the consideration of these issues affects the application of current law.

V. COMMENTS REQUESTED

Comments regarding the guidance under consideration described in Part III of this notice are requested. Of particular interest to Treasury and the Service are comments regarding the extent to which qualified defined benefit plans currently offer the types of benefits described in Part III of this notice, and comments regarding any appropriate transition rules that should be included in the guidance.

Written comments should be submitted by May 13, 2007. Send submissions to CC:PA:LPD:PR, (Notice 2007-14), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, D.C. 20044. Comments may also be hand delivered Monday through Friday between the hours of 8:30 a.m. and 4:00 p.m. to: Internal Revenue Service, CC:PA:LPD:PR, (Notice 2007-14), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington DC. Alternatively, comments may be submitted via the Internet at notice.comments@irs.counsel.treas.gov (Notice 2007-14). All comments will be available for public inspection.

DRAFTING INFORMATION

The principal authors of this notice are Pamela R. Kinard and Preston Rutledge of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities) and Kathleen Herrmann of the Employee Plans, Tax Exempt and

therefore is protected under § 204(g) of the Employee Retirement Income Security Act of 1974).

Government Entities Division. For further information regarding this notice, contact Ms. Kinard at (202) 622-6060 or Mr. Rutledge at (202) 622-6090 (not toll-free numbers).