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CRITICAL AMENDMENT DEADLINE APPROACHING FOR DEFINED BENEFIT PLANS

Sponsors of single-employer defined benefit pension plans will need to amend those plans soon to comply with a critical requirement of the Pension Protection Act of 2006 (the PPA). As explained more fully below, meeting this deadline is crucial because the IRS has conditioned anti-cutback relief on a timely amendment. If the cutbacks *required* under the PPA are implemented without a timely amendment, the plan risks disqualification, and the plan sponsor may be liable to participants and beneficiaries.

MANDATORY FUNDING-BASED RESTRICTIONS

One of the many requirements introduced by the PPA was a new regime of restrictions on benefit *accruals* under, *distributions* from, and *amendments* to certain underfunded defined benefit plans. These restrictions arise under Section 436 of the Tax Code, a new section added by the PPA. Under Section 436, a plan's underfunded status triggers the following mandatory cutbacks:

- If the plan has an adjusted target funding attainment percentage (AFTAP) of less than ***60 percent*** for a plan year:
    - o the plan is not permitted to make lump-sum distributions or certain other accelerated payments, such as unpredictable contingent event benefits (e.g., plant shutdown benefits), and
    - o benefit accruals under the plan must cease.
- If the plan has an AFTAP of less than ***80 percent*** for a plan year (but not less than 60 percent):
    - o the portion of any benefit that may be paid as a lump sum (or other accelerated form) is limited, and
    - o the plan cannot be amended to increase benefits.

  (The Section 436 rules are quite complex and have been simplified for purposes of this summary.)

CATCH 22: PPA'S ANTI-CUTBACK RELIEF

Thus, Section 436 *requires* benefit cutbacks (based on a plan's funded status) that are specifically *prohibited* by the anti-cutback rules in ERISA and the Tax Code. To resolve this contradiction, the PPA created a limited window during which sponsors may adopt the necessary amendments *without* violating the anti-cutback rules.

WHEN AND WHY NEW AMENDMENTS ARE NECESSARY

Although the Section 436 restrictions have been in effect since the first day of the plan year that began in 2008, Congress has since revised the applicable funding rules (in both the Worker, Retiree, and Employer Recovery Act of 2008 and the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010).

Moreover, following the PPA's enactment, the IRS has issued no fewer than five pieces of formal guidance on Section 436 (two sets of proposed regulations, two notices, and final regulations). As the statutory changes and regulatory guidance have accumulated, the IRS has repeatedly extended the amendment deadline--and therefore the anti-cutback relief. (We first reported on this delay in an August 2010 article.)

Those extensions are now at an end. Late last year, in Notice 2011-96, the IRS finally issued a model amendment and finalized the Section 436 amendment deadline. Although there are exceptions, the general deadline is the last day of the 2012 plan year. For calendar-year plans, this makes the deadline December 31, 2012.

Many sponsors have long-since adopted a "good-faith" Section 436 amendment as part of a comprehensive amendment to implement the PPA. Sponsors should no longer rely on these temporary amendments. Instead, these place-holders should be replaced with the IRS's model language *before* the applicable deadline to ensure that any benefit reductions required under Section 436 are protected by the PPA's anti-cutback relief.

OPTIONAL PROVISIONS

In addition to formalizing the Section 436 rules, the IRS's model amendment includes four optional modifications. Each of these aims to help participants who are adversely affected by mandatory benefit restrictions.

Two of these optional provisions would allow participants who are prohibited from taking accelerated distributions to later elect those distributions when the plan's funding level has improved sufficiently for the Section 436 restrictions to be lifted. The third expands the timing and payment options available to participants during any period when distribution options are limited by Section 436. The fourth optional provision automatically restores benefit accruals that were cancelled during a period when such accruals were limited by Section 436. Sponsors may elect any or all of these options.

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