IRC §412(d)(2): What We Know and What We Don't

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IRC §412(d)(2)

For purposes of this section, any amendment applying to a plan year that:

A. Is adopted after the close of such plan year but no later than 2½ months after the close of the plan year (or, in the case of a multiemployer plan, no later than 2 years after the close of such plan year)

B. Does not reduce the accrued benefit of any participant determined as of the beginning of the first plan year to which the amendment applies, and

C. Does not reduce the accrued benefit of any participant determined as of the time of adoption except to the extent required by the circumstances

Shall, at the election of the plan administrator, be *deemed to have been made* on the first day of such plan year.

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What Changed?

- Nothing changed in the letter of the law.
- Pre-PPA, IRC§412(c)(8) included exactly the same text as the current §412(d)(2).
- Pre-PPA, §412 included all funding rules, but post-PPA incorporates by reference to §430 for single employer plans, §431 for multis and now §433 for CSEC plans.

Signs of Trouble

- 2011 Gray Book Q.4 said a retroactive discretionary amendment could not be made after year end and taken into account for the prior year.
  - Simply said, an amendment is only reflected in FT and TNC for the prior plan year if it is "adopted and takes effect by the end of the prior plan year."
  - No mention in the response of the §412(d)(2) statement that the amendment would be "*deemed to have been made* on the first day of such plan year".
  - Pointed out that a §1.401(a)(4)-11(g) amendment adopted after the end of the year is treated as effective in the prior year for coverage and nondiscrimination, but is treated like any other amendment for funding purposes.

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Response

- ASPPA/ACOPA sent a letter to Treasury, and had a meeting, in July 2011 expressing concern about this interpretation.
  - §412(d)(2) "has been applied in the straight-forward manner in which it is written" for many years, and there has been no statutory change to justify a change in the IRS position.
  - Gray book interpretation "runs counter to decades of interpretation and practice with regard to this provision."
  - IRS position totally ignores "*deemed to have been made*" language of statute.

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More Signs of Trouble

- In the DL process, the IRS began objecting to past 412(d)(2) amendments (and pre-PPA 412(c)(8) amendments), saying they violate the qualification requirements.
  - Generally referred to Rev. Proc. 2007-44, which requires a discretionary amendment to be adopted no later than the last day of the plan year.
  - Plan sponsors were told they had to enter into a closing agreement or withdraw the application to avoid a negative ruling.

Poll #1

- Did you have a DL request where IRS questioned a past §412(c)(8) or § 412(d)(2) election?
  - Yes
  - No

Further Response

- ASPPA/ACOPA sent another letter on June 9, 2014:
  - IRS should affirm the statutory language of §412(d)(2).
    - The letter noted that Sec. 5.07 of Rev. Proc. 2007-44 provides an exception where a "statutory provisions or guidance" provides an earlier or later deadline.
  - Any DL application being threatened with an adverse letter should be put in abeyance. If there is a change in policy, IRS should engage in dialogue, not threaten disqualification.
- Meeting with IRS/Treasury held July 24, 2014. Threatened adverse letters held in abeyance.

Recent Progress

- December 16, 2015 IRS internal memo on “Deadline for Adoption of Discretionary Plan Amendments”
  - Https://www.irs.gov/pub/foia/ig/spder/TEGE-07-1215-0026.pdf
- Provides guidance for IRS EP Determinations and Examinations employees reviewing §412(d)(2) amendments.
- Says Rev Proc 2007-44 section 5.05(2) “does not bar a plan amendment that increases accrued benefits retroactively but is not operationally effective until after the end of that prior year.”
- Directs DL agents to conclude the amendment does not adversely affect qualification in form.

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Recent Progress (Continued)

- Says it is temporary, but don't worry – to be incorporated into IRM 7.11.1.12 by the expiration date of the memo.
- If you had any DL's in limbo over this issue, should have been, or soon be, released.

Open Issue

- Still no answer on impact on FT and TNC calculations
- Higher deductible limits post-PPA make it less significant, but still situations where it would be helpful, usually involving a fairly new plan.
  - Plan formula not at 415 limit, sponsor deposits a very large contribution mid-year and you discover it after year end (and within 2½ months).
  - Plan frozen due to economic difficulties after just a couple of years. Business recovers, owner wants to reinstate accruals for prior year, and deduct a contribution for that year.

Poll #2

- Have you worked on a plan that has made § 412(d)(2) election since 2008? Or would you have benefitted from one if there was not the recent uncertainly about it?
  - Yes
  - No

Issues to Be Addressed

- Does the §412 reference to §430 incorporate §436 by reference? Or is §436 unaffected by a §412(d)(2) election?
- Example: Calendar-year plan. Amendment adopted 2/15/16 increasing benefits effective 1/1/2015. Plan administrator makes a §412(d)(2) election to treat the amendment as if it were adopted on 1/1/2015 for funding purposes. Is the determination as to whether the amendment can be effective under §436(c) to be made:
  - For 2015?
  - For 2016?
  - Both?

§436 and §412(d)(2)

- §1.436-1(c)(5):

  "Rule for determining when an amendment takes effect. For purposes of section 436(c) and this paragraph (c), in the case of an amendment that increases benefits, the amendment takes effect under a plan on the first date on which any individual who is or could be a participant or beneficiary under the plan could obtain a legal right to the increased benefit of the individual were on that date to satisfy the applicable requirements for entitlement to the benefit…."

§436 and §412(d)(2) (Continued)

- Strong argument that §1.436-1(c)(5) does not conflict with the statutory language of §412(d)(2), but simply determines whether or not there is an amendment that will be effective for which a §412(d)(2) election can be made.
- For §436(c) purposes, amendment is effective 2/15/16.
- Guidance needed to address mechanical issues, such as:
  - What if an amendment is adopted and $412(d)(2) election made, then amendment turns out to not be effective because of 436(c)?
- §430 guidance may need to be revised.

§1.430(d)-1(d)

- §1.430(d)-1(d) "*Plan provisions taken into account.*

  ……

- (ii) *Plan provisions adopted after valuation date*. If a plan administrator makes the election described in section 412(d)(2) with respect to a plan amendment, then the plan amendment is treated as having been adopted on the first day of the plan year for purposes of this paragraph (d). Section 412(d)(2) applies to any plan amendment adopted no later than 2-1/2 months after the close of the plan year, including an amendment adopted during the plan year. Thus, if an amendment is adopted after the valuation date for a plan year (and no later than 2-1/2 months after the close of the plan year), but takes effect by the last day of the plan year, the amendment is taken into account in determining the plan's funding target and target normal cost for the plan year if the plan administrator makes the election described in section 412(d)(2) with respect to such amendment." **(Underline added)**

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§1.430(d)-1(d)

(iii) *Determination of when an amendment takes effect*. For purposes of this paragraph (d)(1), the determination of whether an amendment that increases benefits takes effect and when it takes effect is determined in accordance with the rules of section 436(c) and §1.436-1(c)(5). For purposes of this paragraph (d)(1), in the case of an amendment that decreases benefits, the amendment takes effect under a plan on the first date on which the benefits of any individual who is or could be a participant or beneficiary under the plan would be less than those benefits would be under the pre-amendment plan provisions if the individual were on that date to satisfy the applicable conditions for the benefits. In either case, the determination of when an amendment takes effect is unaffected by an election under section 412(d)(2)." **(Underline added)**

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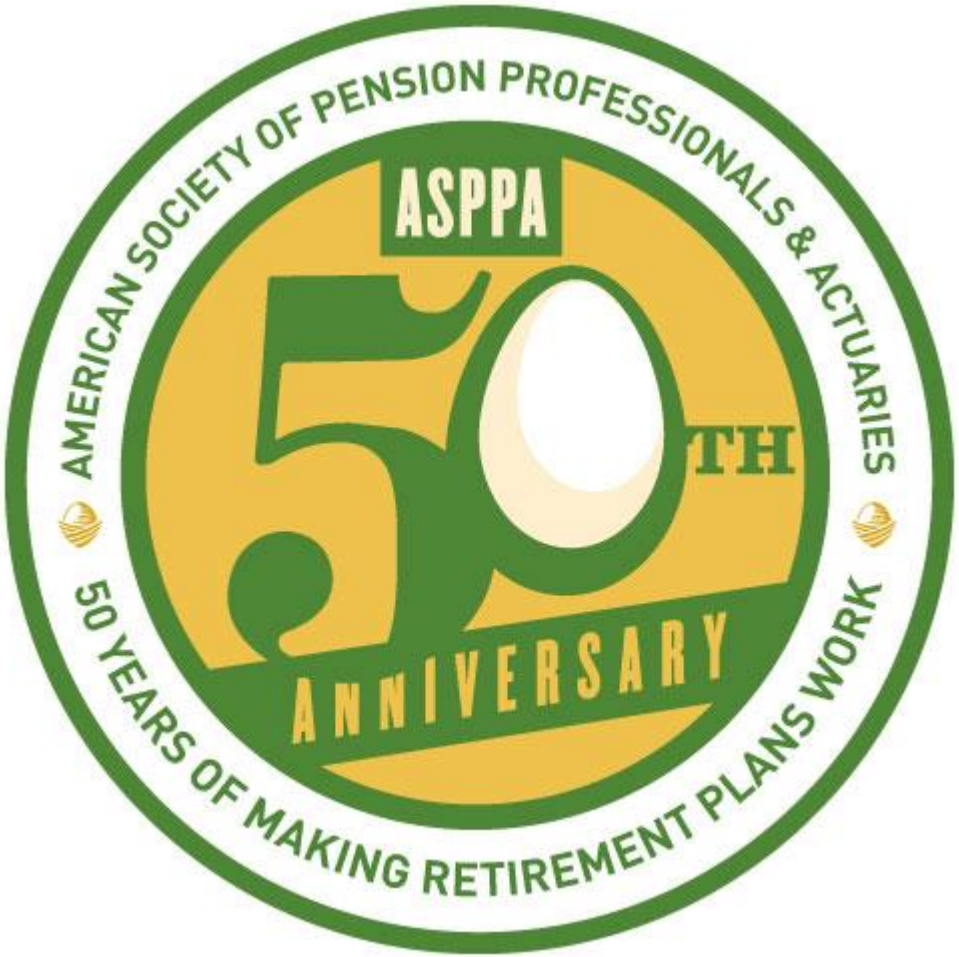
Nondiscrimination and §412(d)(2)

- Same example – calendar-year plan, 2/15/16 amendment adoption with retro effective date, §412(d)(2) election to treat as effective 1/1/15. When is the amendment tested for 401(a)(4)?
- Answer – 2016. Unless the amendment is also a §401(a)(4)-11(g) amendment.
  - 11(g) "corrective" amendments are to satisfy coverage and/or nondiscrimination requirements.
  - Among other requirements, § 1.401(a)(4)-11(g)(3)(v) includes a condition that the retroactive increased benefits must satisfy 401(a)(4) on their own.

Final Resolution?

- IRS has assured us they are working on this, but not to expect it any time soon.
- When guidance is eventually issued, may address other questions that have arisen around §412(d)(2) elections, some post-PPA issues and some not.
  - What if a §412(d)(2) election results in underpayment of quarterly contributions?
  - Or creates a §436(c) problem for an amendment adopted during the year that was ok without the retroactive amendment?

Questions?



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