

# **Cutback the Complexity!**

## **Making Sense of the Anti-Cutback Rules**



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# Anti-Cutback Rules Prohibit:

- 1) Decreasing an accrued benefit; or
  - 2) Eliminating an optional form of benefit
- Typically find anti-cutback issues:
    - Amendments
    - TPA takeovers
    - Mergers or acquisitions

# DB Reducing Benefits

- Accrual formula = Two percent of average compensation times years of participation
- 1,000-hour requirement for year of participation
- Plan sponsor experiencing financial trouble in 2017
- Amend to one percent of average compensation on November 1, 2017?

# Poll #1: DB Reducing Benefits

Decreasing an accrued benefit by decreasing formula?

- A. Yes
- B. No
- C. Maybe
- D. Don't Know

# DB Reducing Benefits (Continued)

- Yes, protected benefit
- Anti-cutback rules protect benefits accrued as of amendment date
- Accrued benefit 2016 and prior
- 2017? Yes
- Permitted to change future accruals

Treas. Reg. § 1.411(d)-3(b)(3)

- Changing future accruals = 204(h) notice
- Failure to provide = \$100 excise tax

IRC §4980F(b)(1)

# DB Reducing COLAs

- Accrual formula = Two percent of average compensation times years of participation
- Cost of living adjustment (COLA) provided after retirement
- Plan sponsor experiencing financial trouble
- Amend to remove COLAs going forward?
- Decreasing an accrued benefit?

# DB Reducing COLAs (Continued)

- Yes, protected benefit
- COLAs considered accrued benefit, which cannot be reduced for future payments

Williams v. Rohm & Haas Pension Plan, 497 F.3d 710 (7th Cir. 2007); Shaw v. International Association of Machinists & Aerospace Workers Pension Plan, 750 F.2d 1458 (9th Cir. 1985)

- Lump-sum payments from terminated plan must take into account post-retirement COLA value

IRS Announcement 95-99

# Voluntary Waiver

- Accrual formula = Two percent of average compensation times years of participation
- 1,000-hour requirement for year of participation
- Plan sponsor experiencing financial trouble in 2017
- Owner would like to reduce his accrual to zero percent for the current year
- Amend effective November 1, 2017?
- Decreasing an accrued benefit?



# Voluntary Waiver (Continued)

- Yes, protected benefit
- Cannot waive accrued benefit to prevent or eliminate underfunding status
- Distinguish between PBGC allowing owner to forego distribution upon plan termination

PLR 9146005;  
Announcement 94-101

# Cash Balance Plans

- Conversion from traditional to cash balance
- Wear-away provision adopted
- Benefit at retirement no less than benefit of traditional plan at time of conversion

# Poll #2: Cash Balance Plans

Decreasing an accrued benefit with wear-away?

- A. Yes
- B. No
- C. Maybe
- D. Don't Know

# Cash Balance Plans (Continued)

- No protected benefit
- Anti-cutback rules protect accrued benefits
- Wear away provisions deal with potential future accruals
- No entitlement to future accruals

Campbell v. BankBoston, N.A.,  
303 F.3d 1 (1st Cir. 2003)

# DC Allocation Formula

- 401(k) profit-sharing plan
- Company has best year ever in 2017
- Plan set up for pro rata PS allocation formula
- Change to cross-tested PS formula effective November 1, 2017?

# Poll #3: DC Allocation Formula

Decreasing an accrued benefit by changing formula?

- A. Yes
- B. No
- C. Maybe
- D. Don't Know

# DC Allocation Formula (Continued)

- May be protected benefit
- Depends upon allocation conditions
- IRS position: right to allocation formula protected once allocation conditions are satisfied
- Considered “protected allocable share”
- Need to review allocation conditions

TAM 9735001

# DC Allocation Formula (Continued)

- Last-day requirement?
- No protected allocable share until last day of plan year
- 1,000-hour requirement?
- No protected allocable share until hour requirement satisfied
- Full-time employee will work 1,040 in six months
- If both last day and 1,000 hour?
- No protected allocable share until last day of plan year



# DC Allocation Formula (Continued)

- No allocation conditions?
- Protected allocable share as soon as participant works one hour
- For discretionary contributions, sponsor has ability to not contribute at all – so isn't protected allocable share really nothing?

# Allocation Conditions

- Executive leaves August 2017
- Front-loaded her salary deferrals
- Discretionary matching contribution
- No allocation conditions on match
- Owner really upset she left and doesn't want to provide her any additional benefits
- Add a last-day allocation condition?

# Poll #4: Allocation Conditions

Decreasing an accrued benefit by changing conditions?

- A. Yes
- B. No
- C. Maybe
- D. Don't Know

# Allocation Conditions (Continued)

- Yes, protected benefit
- Protected allocable share as soon as participant works one hour
- If discretionary match is contributed, must include executive
- Alternative is to not provide a match at all

Treas. Reg. § 1.411(d)-4, Q&A 1(d)(8)

# DC Safe Harbor Plan

- 401(k) safe harbor plan
- Could be either match or non-elective safe harbor
- Plan sponsor experiencing financial trouble in 2017
- Eliminate effective November 1, 2017?
- Decreasing an accrued benefit?

# DC Safe Harbor Plan (Continued)

- Yes, protected benefits
- Anti-cutback rules only protect benefits accrued as of amendment date
- Must provide safe harbor contributions up to amendment date
- Satisfy other conditions under Treas. Reg. § 1.401(k)-3(g)
- No protected benefit to safe harbor contributions after November 1, 2017
- Allowed to change future accruals or even terminate the plan

Treas. Reg. § 1.411(d)-3(b)(3)

# Distribution Timing

- Executive leaves August 2017
- Rumored to be starting a competing business
- Completed distribution form
- Plan document states distributions to be paid as soon as possible
- Can you delay payment? For example, amend plan for distributions to be paid after the last day of the plan year in which termination occurs?

# Poll #5: Distribution Timing

Eliminating an optional form of benefit by changing distribution timing?

- A. Yes
- B. No
- C. Maybe
- D. Don't Know



# Distribution Timing (Continued)

- Yes, protected benefit
- Optional form of benefit = distribution alternative available with respect to accrued benefits
- Includes timing of distribution
- Only delay distribution timing for future accruals
- Too late for terminated executive

Treas. Reg. § 1.411(d)-3(g)(6)(ii)(A)

# DB Distribution Options

- Plan offers following distribution options:
  - Straight life annuity
  - Life annuity with ten-year certain
  - 100 percent joint and survivor annuity
  - 75 percent joint and survivor annuity
  - 50 percent joint and survivor annuity
  - Lump-sum distribution
- Sponsor wants to narrow options to reduce administrative costs

# Poll #6: DB Optional Forms of Benefit

Eliminating an optional form of benefit by removing some of the distribution options?

- A. Yes
- B. No
- C. Maybe
- D. Don't Know

# DB Distribution Options (Continued)

- Potential exception to anti-cutback rules!
- May eliminate redundant optional forms
  - Satisfy redundant elements (i.e., “families of options”)
  - Cannot apply until 180 days after amendment

Treas. Reg. § 1.411(d)-3(c)

- May also eliminate “noncore” optional forms
  - Cannot be defined as a “core” option
  - Cannot apply until four years after amendment

Treas. Reg. § 1.411(d)-3(d)

# DB Actuarial Assumptions

- Plan's normal form of benefit is life annuity
- Lump-sum option also available
- Determined by applying six percent preretirement interest
- Amend to increase preretirement interest to eight percent after December 31, 2017?

# DB Actuarial Assumptions (Continued)

- Yes, protected benefit
- Lump sum would be determined as greater of:
- Accrued benefit as of December 31, 2017 applying six percent preretirement interest rate; or
- Total accrued benefit applying eight percent preretirement interest rate

Rev. Rul. 81-12

- No anti-cutback if using fluctuating 417(e)(3) rates

Rev. Rul. 2007-67

# DB Early Retirement Benefits

- DB plan offers early retirement benefit for participants who:
  - Attain age 55; and
  - Performed 20 years of service
- No participant is over age 55 nor worked 20 years
- Sponsor wants to eliminate early-retirement benefit as of December 31, 2017
- Eliminating an optional form of benefit?

# DB Early Retirement Benefits (Continued)

- Yes, protected benefit
- But only for accrued benefit as of December 31, 2017
- Participant who is age 30 with five years of service would still be able to elect early retirement
- But the early retirement benefit will be based on accrued benefit as of December 31, 2017

Treas. Reg. § 1.411(d)-3(g)(6)(i)

- Generally does not apply to early retirement windows
- Created for limited time without subsequent amendment to eliminate

Rev. Rul. 92-66



# DB Subsidized Early Retirement

- DB plan offers subsidized early retirement benefit for participants who:
  - Attain age 55; and
  - Performed 20 years of service
- Participant terminates in 2016 at age 50 with 25 years of service
- Plan amended to eliminate subsidized early retirement benefit as of December 31, 2017
- Terminated participant eligible for benefit at age 55?
- Eliminating an optional form of benefit?

# DB Subsidized Early Retirement (Continued)

- Yes, protected benefit
- Terminated participants can “grow” into early retirement benefits
- Cannot require continued employment to be considered protected benefit

Alcantara v. Bakery & Confectionery Union & Industry International Pension Fund Pension Plan, 751 F.3d 71 (2nd Cir. 2014)

# DC Distribution Options

- Vendor change for an existing 401(k) plan
- Plan provides QJSA and other annuity options
- No MPPP nor DB assets
- Do you have to deal with notice and consent requirements?

# Poll #7: DC Distribution Options

Eliminating an optional form of benefit by removing some of the distribution options?

- A. Yes
- B. No
- C. Maybe
- D. Don't Know

# DC Distribution Options (Continued)

- Exception to anti-cutback rules!
- DC may eliminate annuity options for accrued benefits

IRC § 411(d)(6)(E);

Treas. Reg. § 1.411(d)-4, Q&A 2(e)

- No need to provide notice to participants before effective date

ERISA § 204(h)(1);

Treas. Reg. § 54.4980F-1, Q&A 3(a)

# ESOP Distribution Options

- Presenting at an enrollment meeting
- Employee wants to roll money into plan from an ESOP
- She received a notice from ESOP sponsor that lump-sum distributions no longer permitted
- She is upset because she wants all retirement funds in one place
- Eliminating an optional form of benefit?

# ESOP Distribution Options (Continued)

- Exception to anti-cutback rules!
- Applies when ESOP subject to put option requirement
- ESOP may modify distribution options for accrued benefits
- Also may modify distribution timing

IRC § 411(d)(6)(C);

Treas. Reg. § 1.411(d)-4, Q&A 2(d)

# In-Service Distributions

- Client buys another company with existing plan
- Client wants to merge plans
- Acquired plan allows PS account to be distributed after five years participation or contribution in plan at least two years
- Client's plan only allows in-service upon normal retirement age (65)
- Eliminate acquired plan's in-service distribution option for pre-merger account balances?



# Poll #8: In-Service Distributions

Eliminating an optional form of benefit by removing in-service distribution option?

- A. Yes
- B. No
- C. Maybe
- D. Don't Know

# In-Service Distributions (Continued)

- Yes, protected benefit
- Optional form of benefit includes distribution alternatives for accrued benefits
- PS assets acquired must still be permitted in-service after five years participation or two years after contribution
- Future PS contributions to client plan for acquired employees may only permit in-service upon NRA

Treas. Reg. § 1.411(d)-3(g)(6)(ii)

# Protected Earnings?

- Are earnings also entitled to protection under anti-cutback rules?
- Just account balance at time of merger permitted in-service after five years participation or two years after contribution?
- Or account balance at time of merger PLUS future earnings?
- Protection of eliminated in-service distribution option may be limited to account balance at the time of merger
- Depends on R/K system

# Hardship Withdrawals

- Client buys another company with existing plan
- Client wants to merge plans
- Acquired plan allows hardship distributions
- Client plan does not and does not want to start
- Eliminate acquired plan's ability to take hardship distributions on pre-merger account balances?
- Eliminating an optional form of benefit?

# Hardship Withdrawals (Continued)

- Exception to anti-cutback rules!
- May eliminate hardship-distribution option
- Different than inability to eliminate other in-service distributions
- Sponsor can also limit hardship availability
  - Purchase principal residence
  - Medical expenses
  - Education expenses
  - Etc.

Treas. Reg. § 1.411(d)-4, Q&A 2(b)(2)(x)

# Mandatory Cash-Outs

- Plan document requires cash-outs if less than \$1,000
- Client wants to reduce administrative costs
- Can cash-out limit be raised to \$5,000 (with rollover to IRA)?

# Poll #9: Mandatory Cash-out

Eliminating an optional form of benefit by increasing mandatory cash-out amount?

- A. Yes
- B. No
- C. Maybe
- D. Don't Know

# Mandatory Cash-Outs (Continued)

- Exception to anti-cutback rules!
- Cash-out threshold permissible under statutory law
- Sponsor may increase cash-out from \$1,000 to \$5,000 without violating anti-cutback rules

Treas. Reg. § 1.411(d)-4, Q&A 2(b)(2)(v)



# Correcting Errors

- Calculation error results in participants receiving allocations or accruals above amount stated in plan or authorized by plan sponsor
- Error found two years later
- Can accrued benefit or account balance be reduced?
- Decreasing an accrued benefit?

# Correcting Errors (Continued)

- Not a protected benefit
- Incorrect accrual or allocation is not an accrual of benefits subject to protection
- Participant not entitled to benefit
- Corrections including reductions in accrued benefit or account balance permitted

Rev. Proc. 2016-51, Appendix B

# Ancillary Benefits

- Not protected benefits:
  - Ancillary life-insurance protection
  - Accident or health-insurance benefits
  - Most social security supplements
  - Availability of loans
  - Right to make after-tax employee contributions or elective deferrals

Treas. Reg. § 1.411(d)-4, Q&A 1(d)

# Ancillary Benefits (Continued)

- Not protected benefits:
  - Right to direct investments
  - Right to a particular form of investment
  - Allocation dates or time for contributions and valuation dates for account balances
  - Administrative procedures for distributions
  - Rights that derive from administrative and operational provisions (allocating earnings in DC account)

Treas. Reg. § 1.411(d)-4, Q&A 1(d)

# Ancillary Benefits (Continued)

- May be eliminated from the plan
  - Participant loan features
  - Self-directed brokerage accounts
  - Ability to purchase life insurance
    - Force liquidation of existing insurance contracts unless participants agree to purchase outside of plan

Treas. Reg. § 1.411(d)-3(b)(3)(i)

DOL PTE 92-6

# Plan Eligibility

- Plan allows employees to participate immediately
- Employee hired June 18, 2017 began to defer salary to 401(k) plan on July 1, 2017
- Sponsor has come to you to save administrative expenses
- You recommend one year of service eligibility due to turnover of workforce
- Sponsor agrees and wants to amend the plan immediately to require one year of service
- Is employee above prevented from continuing to defer until completion?

# Poll #10: Plan Eligibility

Decreasing an accrued benefit by employee no longer being eligible for the plan until new condition satisfied?

- A. Yes
- B. No
- C. Maybe
- D. Don't Know

# Plan Eligibility (Continued)

- Not protected benefit
- Accrued benefit (deferrals) remain in plan
- Only impacts future accruals
- Ability to defer is an ancillary benefit
- Sponsor could, but not required to, make new eligibility conditions applicable to only employees hired after amendment

Treas. Reg. § 1.411(d)-4, Q&A 1(d)



# Summary

## 1) Decreasing an accrued benefit

- Accrual or allocation formula
- Cost of living adjustments
- Allocation conditions
- May reduce future benefits
- Cash balance wear-away
- Correcting errors
- Ancillary benefits not protected

# Summary (Continued)

- 2) Eliminating an optional form of benefit
  - Distribution timing
  - Distribution options (actuarial assumptions and early-retirement benefits)
    - Except DB redundant or noncore options
    - Except DC annuity options
    - Except ESOP distribution options
    - Except hardships
    - Except mandatory cash-outs

# Questions?