Workshop 24: DB Plan Termination Gotchas

Steven J. Levine, EA, MSPA
sjlevine@bestweb.net
914-232-5451

Mary Ann Rocco, EA, MSPA
mar@RoccoEA.com
714-393-8845
INTRO

Simple Definition of ‘GOTCHA’: an unexpected problem or usually unpleasant surprise.

Full Definition: an unexpected usually disconcerting challenge, revelation or catch; also: an attempt to embarrass, expose or disgrace someone with a gotcha.

“A SMART MAN MAKES A MISTAKE, LEARNs FROM IT, AND NEVER MAKES THAT MISTAKE AGAIN. BUT A WISE MAN FINDS A SMART MAN AND LEARNS FROM HIM HOW TO AVOID THE MISTAKE ALTOGETHER.”

ROY H. WILLIAMS
• Missing a deadline in the termination process

### INTRO

**Termination Timeline Worksheet**

<table>
<thead>
<tr>
<th><strong>STEP</strong></th>
<th><strong>TIMING</strong></th>
<th><strong>Earliest Date</strong></th>
<th><strong>Latest Date</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Resolution / Plan Amendments</td>
<td>Generally by PTD</td>
<td>PTD</td>
<td>PTD</td>
</tr>
<tr>
<td>ERISA 204(h) notice</td>
<td>At least 15 days prior to cessation of accruals (45 for larger plans 100+)</td>
<td>PTD/Freeze Date - 15</td>
<td>PTD/Freeze Date - 15</td>
</tr>
<tr>
<td>Notice of Intent to Terminate</td>
<td>At least 60 days but no more than 90 days prior to PTD</td>
<td>PTD</td>
<td>PTD</td>
</tr>
<tr>
<td>Notice to Interested Parties</td>
<td>At least 7 days but no more than 24 days prior to filing 5310</td>
<td>Filing date - 24</td>
<td>Filing date - 7</td>
</tr>
<tr>
<td>IRS form 5310 et al.</td>
<td>Prior to filing form 500 (can file later but lose extension on PBGC distribution deadline)</td>
<td>PTD + 180</td>
<td>PTD + 180</td>
</tr>
<tr>
<td>Notice of Plan Benefits</td>
<td>Prior to filing PBGC Form 500</td>
<td>500 Filing Date</td>
<td>PTD + 180</td>
</tr>
<tr>
<td>PBGC form 500 et al.</td>
<td>No later than 180 days (6 months) after PTD</td>
<td>500 Filing Date</td>
<td>PTD + 180</td>
</tr>
<tr>
<td>Notice of Annuity Information</td>
<td>No later than 45 days prior to distribution of plan assets</td>
<td>Include in NOIT</td>
<td></td>
</tr>
<tr>
<td>Distribution of Plan Assets</td>
<td>Title IV: 240 days after 500 filed/or 120 days after LOD/ Non-Title IV: generally 1 year after PTD.</td>
<td>Filing Date + 60</td>
<td>Filing date + 240</td>
</tr>
<tr>
<td>Notice of Annuity Contracts</td>
<td>No later than 30 days after distributions completed</td>
<td>Distribution Date</td>
<td>DD + 30</td>
</tr>
<tr>
<td>PBGC Post Distribution Form 501</td>
<td>No later than 30 days after final distribution, no penalty if 90 days.</td>
<td>DD</td>
<td>DD + 90</td>
</tr>
<tr>
<td>Final PBGC Premium filing</td>
<td>Earlier of normal deadline or date 501 filed</td>
<td>501 filing date</td>
<td>501 filing date</td>
</tr>
<tr>
<td>Final Form 5500 / 5500-SF / 5500-EZ</td>
<td>No later than 7th month after final dist.</td>
<td>DD + 7 months</td>
<td>DD + 7 months</td>
</tr>
</tbody>
</table>
INTRO

• Filing for a Letter of Determination/5310
• What if issue is discovered by Agent that requires Audit CAP?

• Determine any issues before filing.

INTRO

• Does filing a 5310 for a Determination Letter (DL) make audit less likely?

• Or more likely?
INTRO

Client is blindsided by costs and work associated with term.

- 5310/500 Timeline.
- 5500 filings.
- Valuation, SB and potential Term year funding.
- PBGC Premiums.
- Expected Date of Distribution.
- Billing and Fees.

EXISTING DOCUMENTS

• Gather ALL signed Documents / 204(h)
• Adopt RAP good-faith changes by PTD
  ➢ 5310 filing extends RAP
• Plan terminates during restatement window whereby restatement not required...but
  ➢ good-faith interim amendments not reviewed by IRS vs IRS reviewed plan language.
**Existing Document**

- Takeover to terminate...a game of

  Can you find the mistake?

  1 2 3 4 5 6 7 8 9

**Existing Document**

- No PPA interim amendments / 417(e)

  ➢ Title IV PBGC Plan – file VCP ‘late amender’ do not terminate until VCP has approved retroactive application of PPA 417(e) rates.

    » PBGC will accept late 417(e) amenders that have been blessed by IRS if completed before PTD.

  ➢ Non-PBGC –can plan terminate before VCP application and still use new rates at distribution?
TERMINATION AMENDMENT

• Amendment & Resolution to set PTD.
  ➢ Written action for Sole-Prop’s and Partners
• PBGC Plans - set PTD within PBGC guidelines and rules.
• Non-PBGC Plans can terminate on date action taken.
  ➢ 15 day advance notice required if benefits being reduced, ie plan not already frozen.

Termination Amendment

• If Plan not already frozen include freeze date
  ➢ Avoids negative consequence if termination nullified or rescinded.

• Close entry if it makes sense.
Termination Amendment

• Provide 204(h) notice for freeze date.
  ➢ 15 days small plans, 45 days for large.
  ➢ Not necessary if plan already frozen.

• If the only method of ceasing benefit accruals is the plan terminating (bad idea)
  ➢ Non-PBGC Plan requires a 204(h) notice.
  ➢ PBGC Plans do not – NOIT will suffice.
    » See §54.4980F-1 Q-17

Termination Amendment

• Address issues such as compensation period for year of termination
  ➢ Clarifying a silent Document, or
  ➢ Changing terms of specific plan language.
Termination Amendment

• Fully Vest Participants under termination
  ➢ Document may have full vesting language built in, and include to the extent funded
  ➢ Can partially vested stay partially vested if paid after NOIT but before PTD?

➤ ‘100% vesting conditioned upon finalization of the Plan Termination’.

Termination Amendment

• Will plan have Excess Assets or Insufficient Assets?
• Check document to see how both potential situations handled.
• Include either clarity or allowable changes on existing plan language.
Termination Amendment

• **REALLOCATE EXCESS**

• Can amend any DB from Revert to Allocate by PTD. (§1.411(d)-2(a)(2))

➤ Check your document for current reallocate language and see if amendment needed.

» Some documents have vague ‘on a non-discriminatory basis’ built in.

» Others might have a formula like PVAB on 1% of pay that can be amended.

Termination Amendment

• **REALLOCATE EXCESS**

➤ Non-specific language in term amendment:

» such excess shall be allocated to the Participants in a non-discriminatory manner that complies with the Internal Revenue Code and regulations thereunder.

» including but not limited to 401(a)(26), 401(a)(4), 410(b), 416 and 415.

» Aggregated with Defined Contribution Plan
Termination Amendment

• Reallocation treated as accrual increases subject to all usual rules.
  ➢ 401(a)(26)
  ➢ 410(b) and Top Heavy
    » Stand alone or combined with DC plan.
  ➢ 401(a)(4)

• If there are regular plan accruals in the year of termination they will be combined with the excess asset accrual for testing.

Termination Amendment

• 401(a)(4) options
  ➢ Safe Harbor – also pass 410(b)
    » i.e. pro-rata on PV of 1% x Hi 3 or multiply by YOCS limited to 5.
    » Pro-rata on PVAB
      » Problematic if PVAB’s were non-discriminatory without combining with another Plan (DC) for a)4
  ➢ DB Stand-alone testing.
  ➢ Combine with DC Plan
    » Make sure sponsor understands DC allocations will be required.
Termination Amendment

• **REVERT EXCESS**
  
  • Title IV - can amend from re-allocate to revert but reversion language must be in effect for 5 years (or life of plan if < 5) found in 4044(d)(2)(A) & (B)
  
  • Can plans not covered by PBGC amend to revert w/o regard to 5 year restriction?
    ➢ Plan document language.
    ➢ IRS point of view.

Termination Amendment

• Title IV PBGC Plan Termination with reallocate language
  
  ➢ Owner PVAB = 415 Lump Sum Limit
  ➢ Employee PVAB = $50,000
  ➢ Employee’s 415 LS limit = $300,000
  ➢ Excess assets = $200,000
Termination Amendment

• Reversions are subject to 20% excise tax provided the Plan either...
  ➢ Establishes a Qualified Replacement Plan (QRP) under 4980(d)(2)
  ➢ Increases benefits meeting requirements under 4980(d)(3).
    » Pro-rata increases to qualified participants, not less than 20% of excess is allocated and certain limitations to non-actives.

Termination Amendment

• 4980(d)(2) - QRP transfer is either
  ➢ 25% of the excess amount, or
  ➢ Can reduce 25% by benefit increases adopted in the 60 day period ending on PTD.

• Revenue ruling 2003-85
  ➢ Clarifies that a terminated plan QRP transfer can be more than 25% - up to 100%.
Termination Amendment

• QRP Requirements – include statement?
  ➢ 95% of actives in terminated plan are active Participants in QRP.
  ➢ Direct transfer occurs before reversion.
  ➢ No less than 25% being transferred
    » or 25% less benefit increases adopted in 60 day period ending on PTD.
  ➢ Statement if plan was amended in 60 day period ending on PTD.

Termination Amendment

• QRP Allocation Requirements
  ➢ Allocation in year of transfer, or
  ➢ Credit to suspense account and allocate no less rapidly than ratably over 7 years
    » Include income credited to suspense account
  ➢ If unable to allocate to a participant due to 415, allocate to other participants.
    » If can’t allocate to other participants due to 415 shall be allocated as provided in 415*
Termination Amendment

• If any amount not allocated when QRPlan terminates, remaining amounts allocated to participants up to 415.
  ➢ Unallocated amounts treated as reversion.
• Not a solution if company will no longer exist OR key players will no longer have compensation….

Wait a minute ..... 

Can surplus be “sold”?

• Valuable to underfunded plan sponsor
• Can transfer agreed upon surplus
• Must comply with IRC §414(l)(2)
GCM 39744

“As under current law, there will be no income or excise tax consequences if excess assets are transferred or merged between defined benefit plans maintained by an employer or employers within the same controlled group…….”

Transactions

- Shareholders sell company, division or subsidiary. Plan has surplus

- Buyer has underfunded plan and funding requirement & tax reason
Transactions

- Seller - cash needs and substantial surplus
- All terms negotiated – all assets / liabilities

Transactions

- Benefit security of utmost importance
- Good social use – money stays in plans
- Keeps unhealthy plans off PBGC roles
Transactions – In general

- Evaluate value of forgone deductions
- Seller must consider capital gains tax
- Buyers with underfunding generally are tax exempt or have large accumulated NOL’s

Termination Amendment

- Insufficient Assets
- Title IV Plans
  - Election to make sufficient.
  - Must be Majority owner
    » Individual owning directly or indirectly 50%+ of:
      - Unincorporated trade or business
      - Capital or profits interest in Partnership
      - Voting stock or value of all stock of Corporation,
    » Based on 1563 Attribution rules
Termination Amendment

- Election window: Date Notice of Intent (NOIT) issued up to distribution date.
- Owner status determined at time of election, no lookback.
  - Timing vital if stock sale occurring.
- Spousal consent to waive QJSA.
- If no majority owners, benefits must be fully funded to terminate.

Termination Amendment

- Written Commitment to Fund
  - EA may include the value of a commitment to contribute as a plan asset.
  - See PBGC instructions for sample.
  - Not viable if insolvent.
Termination Amendment

• Non-Title IV Plans:
  ➢ Substantial owners elect to ‘forgo assets’
  ➢ Make Contributions
  ➢ Document language that provides for some other method of allocation.
    » To the extent funded
    » 4044 reference (PBGC Categories)

Termination Amendment

• RR 80-229
  ➢ Allocate in accordance with 4044 Priority Categories.
  ➢ Assets shall be allocated the extent possible so that rank & file receive the same proportion of their PVAB (whether or not non-forfeitable) as shareholder, officer of HCE (HCE).
Termination Amendment

• 4044 priority allocations could lead to a higher percent of PVAB going to an ‘HCE’.
• At worst would lead to pro-rata allocation based on PVAB’s.
• What if DB plan benefits/PVAB based on aggregation with DC plan...
• Would you do without a DL?

Termination Amendment

• Deducting Ctb’s to Terminated Plans.
• Title IV PBGC Plans
  ➢ 404(o)(5) – Can deduct amount necessary to fully fund in year of termination.
• No such language for Non-PBGC Plans.
  ➢ Most plans will have a maximum available deduction in year of termination greater than funding the unfunded.
Termination Amendment

• Can a contribution made in the year after the Plan terminates still be deducted?

Termination Amendment

• CASHOUT THRESHOLD
  • If you think the plan may have missing participants and the document defines the cashout/consent threshold at $1,000 may makes sense to amend to $5,000.
  • Must be amended by PTD.
Termination Amendment

• Under the current PBGC Missing Participant rules, a cashout of $1,000 can lead to higher dollars going to PBGC.
  ➢ Plan Lump Sum = $4,755
  ➢ Category 2 ‘Lump Sum’ = $5,071
  ➢ Category 3 ‘Annuity’ = $6,600

Amount owned to PBGC = $6,600 + $300 = $6,900.

Termination Amendment

• Any other issues that should be covered in the Plan Termination Amendment / Resolution?
STANDARD TERMINATION

• Title IV PBGC plans must file Standard Termination with PBGC.
  ➢ Notice of Intent to Terminate (NOIT)
  ➢ Notice of Plan Benefits (NOPB)
  ➢ Form 500, EAS and REP
  ➢ Post Distribution Certification Form 501

Standard Termination

• PBGC most common mistakes
  ➢ Not using correct 417(e) assumptions
  ➢ Not taking greater of Plan vs 417(e)
  ➢ Not correctly preserving optional forms such as lump sum in annuity contracts
  ➢ Not properly transferring Missing Participant money to PBGC
Standard Termination

• What should be in the NOIT?
  ➢ READ THE INSTRUCTIONS and sample NOIT
  ➢ Include anything that starts with “A statement that...”
  ➢ Include notice of annuity information in NOIT to avoid having to provide later.

  » Hartford Life Insurance Co., 200 Hop Meadow, Simsbury, CT 06070, (860) 843-347
  » Principal Life Insurance Company, 711 High Street, Des Moines, IA 503929

Standard Termination

• Special rule for Foreign Language.
  ➢ Applies to all Plans.
    » Plans with less than 100 participants and 25% of more are literate in the same non-English language, or
    » 100 or more, the lesser of 10% or 500.

  ➢ Include prominent legend in that common language advising how to obtain assistance in understanding the NOIT, or provide NOIT in that common language.
Standard Termination

• Miscalculating the PBGC timing requirements...

Standard Termination

• Proposed Termination date can be any day including Saturday, Sunday and Holidays.
• If counting forward - add 60 -90 days to the date the NOIT issued.
  » Counting starts on day after.
  » Open excel and type in NOIT date into A1, type 60 into A2 and add them!
Standard Termination

• Same concept in counting backwards.
• If the 60\textsuperscript{th} day before the PTD is a Saturday the notice is timely if issued on the following Monday even though that’s only 58 days before the PTD.

Standard Termination

• Form 500 filing due 180 days after PTD.
• PBGC instructions state that the PTD can be later than the date in the NOIT provided it complies with timing rules.
  ➢ NOIT issued 3/2/16 with PTD 5/1/16
  ➢ Form 500 filing due 10/28/16
  ➢ Change PTD to 5/31/16 which would extend 500 filing deadline to 11/27/16?
**Standard Termination**

- Date PBGC Receives Standard Term Filing
  - Impacts the earliest and latest date distributions can be made.
    - 61st – 180th day following 500 filing date
    - Distributions to terminees OK if consistent with prior practice and doesn’t jeopardize sufficiency
  - Instructions state that the send date can be the received date if certain conditions met.
    - USPS first class or better, legible post mark etc.

**Standard Termination**

- [http://www.pbgc.gov/about/pg/contact/contact-prac.html#6](http://www.pbgc.gov/about/pg/contact/contact-prac.html#6)

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1. DHL Express (DHL): DHL Same Day Service.
**Standard Termination**

• Can file Form 500 before PTD,

• Can pay terminated participants during
  ➢ NOIT issues 9/30/16
  ➢ PTD = 11/30/16
  ➢ PBGC 500 Receipt Date 10/15/16.
  ➢ Distributions can begin 12/15/16, 61st day after form PBGC received form 500.

**Standard Termination**

• Actuary certifies Assets and liabilities on EAS.
  ➢ Can report liabilities taking into account majority owner waiver into consideration.
    » What if not actually signed by filing date?
  ➢ Can include expected contributions in assets.
    » Written Employer commitment to fund.
Standard Termination

• Standard Term filing must attach
  - Copy of Notice of Intent to Terminate (NOIT)
  - Sample Notice of Plan Benefits (NOPB) for all applicable categories.
    » See Instructions for content details.
    » Actives – consent and non-consent versions
    » Retirees (if applicable)
    » Separated vesteds and non-vesteds (if applicable)
    » Include participants with -0- benefits.

Standard Termination

• 501 Post-Dist Certification due 30 days after distributions.
• PBGC may assess penalty if more than 90 days.
  - Proof of Distributions
  - Copy of plan document and amendments.
  - Can be uploaded http://pbgc.leapfile.com
  - email addresses at PBGC are the employees’:
    lastname.firstname@pbgc.gov
The End