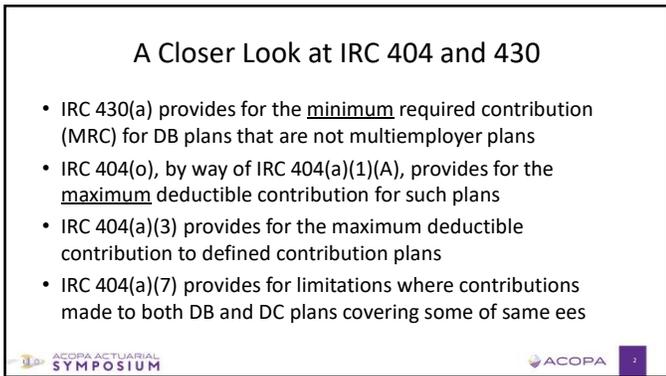


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1



2

A Closer Look at IRC 404 and 430

- Under IRC 430(a)
 - Where assets less than Funding Target, $MRC = \Sigma$
 - Target Normal Cost (TNC)
 - Amortization charges
 - Where assets greater than Funding Target, $MRC =$
 - TNC less excess of assets over FT




3

IRC 404(o)

- Under IRC 404(o)
 - Maximum deductible contribution is greater of
 - MRC, or
 - Amount determined under IRC 404(o)(2)
- IRC § 404(o)(2) amount = Σ
 - FT
 - TNC
 - Cushion Amount, over
 - Assets
 - Subject to floor for plans that are not at-risk




4

IRC 404(o)

- IRC 404(o)(3) Cushion Amount = Σ
 - 50% of FT
 - When calculating cushion, plans with less than 101 participants exclude from FT any liability due to benefit increases for HCEs from amendments “made or effective” (whichever is later) in last 2 years
 - increase in funding target where future compensation increases considered
 - IRC 404(l) comp. limit and 415 benefit limit taken into account – but PBGC plan may ignore 404(l)




5

IRC 404(o)

- Some notes re 2-year rule:
 - In 2002 Graybook Q&A 3:
 - IRC 412(c)(8) (now 412(d)(2)) amendment adopted 3/15/04 effective 1/1/03 increased benefits for HCEs. Per IRS amendment not considered until 2007
 - Date amendment 'made' = date adopted
 - Short plan year not considered a full year; so 2-years = 24 months
 - COLAs under IRC 401(a)(17) and 415(b) not considered amendments
 - RR 2007-28, adoption of plan not considered amendment
 - unless during last 2-years DB plan maintained covering HCE covered by new plan
 - When is HCE status determined?
 - Year of amendment (my –KD - vote) or year deduction being determined?



6

IRC 404(o)

- Plans not at-risk, 404(o)(2) amount not less than:
 - FT, as if plan at-risk; plus
 - TNC, as if plan at-risk; less
 - Assets
- FT & TNC, *as otherwise determined, but with additional assumptions (following slide), and*
 - Load of \$700 per participant added to FT
 - Load of 4% of Non-at risk amt added to FT & TNC
 - Under IRC 430(i) loads only if at risk 2 of prev. 4 years
 - Application of loads to IRC 404 not clear



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IRC 404(o)

- Additional assumptions
 - All employees eligible to commence distribution within 10 years assumed to retire at earliest retirement date (ERD) and commence (most valuable form of) distribution at ERD
 - We will assume lump sum = most valuable form and that lump sums are payable at termination of employment
 - ERD is earliest date participant may receive fully vested distribution (Reg. § 1.401(a)-20 QA 17(b)), but not before end of current PY
 - Recall 3-year full vesting in cash balance plans
 - IRC 430(i)(1)(B)(i) and Regs 1.430(i)-1(c)(3)(ii)(C) / 1.430(i)-1(d)(2)(i)



8

IRC 404(o)

- IRC 404(o)(6) provides for assumptions to be used:
 - “Any computation under this subsection for any plan year shall use the same actuarial assumptions which are used for the plan year under section 430 (determined by not taking into account any adjustment under clause (iv) of subsection (h)(2)(C) thereof).”
emphasis added
 - IRC 430(h)(2)(C)(iv) provides for the interest rate stabilization added by MAP-21
 - I (Kevin) read this to say all IRC 404(o)(2) calcs (i.e. TNC, FT, at-risk TNC and at-risk FT) redone using lower (pre MAP) interest rates

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IRC 404(o)

- Assume a cash balance plan effective 1/1/19 as follows:
 - Annual pay credit of \$100,000
 - Interest crediting rate 5%
 - EOY val
 - Sole participant DOB 12/31/69 (age 50 at 12/31/19)
 - NRA 62 = assumed retirement age (ARA)
 - S2 = 5.35% for IRC 430, assume unadjusted S2 = 4% / S1 = 3%
 - 3-year cliff vesting beginning with effective date
 - What is funding range in year 1?

10

IRC 404(o)

- FT = zero as no benefit at beginning of year, TNC as follows:
 - Projected distribution at ARA = $\$100,000 * 1.05^{12} = \$179,586$
 - TNC = $\$179,586 / 1.0535^{12} = \$96,086$
 - So MRC = \$96,086
- IRC 404(o)(2) amount, first ignoring at risk, also TNC only as no assets and no cushion (as cushion based on FT)
 - TNC = $\$179,586 / 1.04^{12} = \$112,169$
- And what about at-risk floor?

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IRC 404(o)

- Recall from above at-risk assumes distribution at earliest retirement date (ERD) – i.e. effectively upon full vesting
- Since no credit for prior years, full vesting will occur two years from val date
- Projected distribution at ERD = $\$100,000 * 1.05^2 = \$110,250$
- At-risk TNC = $\$110,250 / 1.03^2 = \$103,921$
- Loads (assuming applicable) = $\$700 + (4% * 112,169) = \$5,186$
- At-risk floor = $\$103,921 + 5,186 = \$109,108$

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IRC 404(o)

- So 404(o)(2) amount = $\$112,169$
- And funding range for year 1 = $\$96,086 - \$112,169$

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IRC 404(o)

- Now let's assume $\$100,000$ deposited for 2019 on 9/15/2020 and asset value at 12/31/2020 = $\$102,000$
- Assume segment rates same as 2019
- Acc bal at 12/31/2020 = $\$205,000 [(100,000 * 1.05) + 100,000]$

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IRC 404(o)

- FT based on beginning balance and TNC based on pay credit
- For FT assumed distribution at ARA =
 - $\$105,000 * (1.05^{11}) = \$179,586$
- And for TNC assumed distribution at ARA =
 - $\$100,000 * (1.05^{11}) = \$171,034$

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IRC 404(o)

- For 430 purposes
 - $FT = \$179,586 / 1.0535^{11} = \$101,226$
 - $TNC = \$171,034 / 1.0535^{11} = \$96,406$
- Since assets exceed FT, MRC = TNC less excess
 - $Excess = \$102,000 - 101,226 = \774
- So MRC =
 - $\$96,406 - 774 = \$95,632$

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IRC 404(o)

- IRC 404(o)(2) amount, first ignoring at risk = Σ
 - $FT = \$179,586 / 1.04^{11} = \$116,656$
 - $TNC = \$171,034 / 1.04^{11} = \$111,101$
 - Cushion amount = $\$116,656 * 50\% = \$58,328$, less
 - Assets $\$102,000$
 - $= \$184,085$

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IRC 404(o)

- And at-risk floor (full vesting now one year from val date)
- For FT assumed distribution at ARA =
 - \$105,000 * (1.05) = \$110,250
- And for TNC assumed distribution at ARA =
 - \$100,000 * (1.05) = \$105,000

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IRC 404(o)

- At-risk FT = $\$110,250 / 1.03 = \$107,039$
- And at-risk TNC = $\$105,000 / 1.03 = \$101,942$
- Loads = $\$700 + (4\% * \$111,101) + (4\% * \$116,656) = \$9,810$
- At-risk floor = $\$107,039 + \$101,942 + \$9,810 - \$102,000 = \$116,791$
- So 404(o)(2) amount = $\$184,085$
- And funding range for year 2 = $\$95,632 - \$184,085$

19

IRC 404(a)(7)

- IRC 404(a)(7) applies where employer maintains both DB and DC plan and at least one person covered by both plans
- Deductible limit to combined plans greater of:
 - 25% of compensation, or
 - Deposits to DB plan to extent of greater of
 - MRC, or
 - Excess of the FT over plan assets
 - Note that these amounts are not determined under IRC 404(o) and therefore would appear to be the amounts under IRC 430 (i.e. using MAP rates)

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IRC 404(a)(7)

- IRC 404(a)(7) limit does not apply to extent employer contributions to DC plan do not exceed 6% of compensation (of DC plan 'beneficiaries')
 - Where DC contributions exceed 6% of comp. only DC contributions above 6% considered in 25% limit
 - Effectively translates to 31% limit if all get employer DC dollars (as only compensation of those receiving employer DC contributions considered in determining 6% that is ignored)
 - See IRS Notice 2007-28, Q&A 8 (Thanks Jim)
 - Where DC 6% or less combined plan limit doesn't apply (so may deduct 6% DC plus DB max)
 - Ignore Notice 2007-28, Q&A 9 (Congress fixed Jim's indiscretion)

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IRC 404(a)(7)

- IRC 404(a)(7) limit does not apply to multiemployer plans or to single-employer plans covered by PBGC
 - What is a single employer plan?
 - Is a Multiple Employer plan a single-employer plan?
 - Think ASGs of professional groups where ownership through PCs
 - Prop. Reg. §1.414(m)-3(c) treats such plans as multiple employer plans
 - There is no definition of single employer plan in the IRC
 - But, ERISA 3(41) defines a single employer plan as "... a plan which is not a multiemployer plan."

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IRC 404(a)(7)

- Plans not covered by PBGC
 - Plans covering only substantial owners
 - Plans of "professional service employers" if plan never covered more than 25 active participants
 - Physicians, dentists, D.O.s, O.D.s, lawyers, CPAs, P.E.s, architects, actuaries, others where license requires "advance study"
 - Of late PBGC appears to include CFPs here also
 - <https://www.pbgc.gov/sites/default/files/legacy/docs/coverage-exception-for-professional-service-employer-2017-03-23.pdf>
 - New PBGC procedure for coverage determination

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IRC 404(a)(7)

- Recall from above that the combined plan limits do not apply if there is not at least one participant in both the DB plan and the DC plan
- Are folks in the DC plan only for purposes of elective deferrals considered to be participating in the DC plan?
- Let's look at the law and at PLR 2012-29012

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IRC 404(a)(7)

- IRC §404(n):
 - “Elective deferrals ... shall not be subject to any limitation contained in paragraph (3), (7), or (9) of subsection (a), and such elective deferrals shall not be taken into account in applying any such limitation to any other contributions.” (emphasis added)
- PLR 2012-29012
 - “... an employee who is treated as benefitting (for 410(b) purposes) under a section 401(k) plan ..., but who is not eligible for any employer contributions ..., would not be considered a beneficiary ... for purposes of section 404(a)(3)(A)(i)(I) since section 404(n) of the Code requires the limits on deductible contributions to be applied without regard to ... elective deferrals ...”

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IRC 404(a)(7)

- Consider 6 Drs, 3 of whom want CB plan, 3 of whom just want to max 401(k) plan (no other ees)
- Can Drs in CB plan defer into 401(k) plan without being considered beneficiaries of the k plan?
 - i.e. can they do so but avoid combined plan deduction limits?
 - Per PLR they are not “beneficiaries” in the DC plan so no one is benefitting under both plans!

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IRC 404(a)(6)

- Timing issues
- IRC 430(j) provides that the MRC must be made no later than 8 ½ months after the end of the plan year
 - Note Reg 1.430(a)-1(b)(5) indicating term date prior to end of plan year causes short plan year for 430 purposes
- IRC 404(a)(6) provides that "... a taxpayer shall be deemed to have made a payment on the last day of the preceding taxable year if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof)."

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IRC 404(a)(6)

- Is there a tie between the 2 sections?
- e.g. can a contribution be "on account of" the 2018 taxable year but for MRC purposes be shown on 2019 SB?
 - E.g. MRC = \$0 and tax return extended to 10/15/19
 - Can contribution (up to 404 max) made after 9/15/19 but before 10/15/19 be deducted in 2018
- Or, possibly due to IRC 404(a)(7), deposit made by 9/15/19 due date of tax return would not be deductible but is needed in 2018 for MRC – OK to deduct in 2019 (since made in 2019) when shown on 2018 SB?

28

IRC 404(a)(6)

- In RR 76-28 the Service provided that in order for §404(a)(6) to apply (i.e. allowing deduction in tax year prior to year of deposit), taxpayer must, no later than due date of tax return, either:
 - designate payment in writing (to PA or trustee) as "on account of" employer's "preceding taxable year"; or
 - claim payment as deduction on tax return for preceding taxable year

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IRC 404(a)(6)

- RR 76-28 further provides that a payment may be designated as on account of preceding taxable year (as provided above) at any time on or before the due date (including extensions) of tax return for such year
 - SO, where return filed without taking deduction, amended return may be filed claiming deduction if filed before (extended) due date
 - CONVERSELY, if deduction claimed on preceding year return for post year-end deposit, employer may not amend return to push deduction to current year

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IRC 404(a)(6)

- And RR 77-82:
 - Taxpayer allowed to take deduction in 1975 for contribution made within §404(a)(6) period, but count for §412 (minimum funding) in 1976 (§412 did not apply until years beginning after 1975)
 - ERISA minimum funding rules effective in 1976, so TP wanted to deduct contribution in 1975 but count for funding in 1976
 - Service cited following language in Temp. Reg. §11.412(c)-12(c)(2) (allowing 8½ month post year-end period to satisfy minimum funding in case of pension plans other than single employer DB plans):

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IRC 404(a)(6)

- “The rules of this section relating to the time a contribution ... is deemed made for purposes of ... section 412 are independent from the rules contained in section 404(a)(6) relating to the time a contribution ... is deemed made for purposes of claiming a deduction for such contribution under section 404.” [Temp. Reg. §11.412(c)-12(c)(2)] (emphasis added)

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IRC 404(a)(6)

- PLR 7945115:
 - For 1978 company maintained multiple DB plans
 - During 1978 company deposited \$2.5 million to plans for 1978 PY
 - After 12/31/78 but prior to due date of tax return company deposited additional \$750K for 1979 PY
 - Company wished to deduct the additional \$750K in 1978
 - Citing above Reg. and RRs Service allowed taxpayer to treat contributions in above manner

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IRC 404(a)(6)

- PLR 9107033:
 - For 1988 company maintained three plans – a money purchase plan, a PS plan and a DB plan
 - Contributions to three plans exceeded IRC 404(a)(7) limit
 - Company wished to treat certain contributions to DB plan made after year-end but prior to extended due date of tax return (and funding deadline) as 1988 contributions for minimum funding purposes but as 1989 contributions for deduction purposes
 - Citing above Reg. and RRs Service allowed taxpayer to treat contributions in above manner

34

IRC 404(a)(6)

- Note that with contribution considered 404 contribution for subsequent year, limits of \$404 for following year will apply
 - and they will apply to *all* amounts designated as being “on account of” such subsequent year
 - i.e., contribution is *not added* to following year’s limit - it becomes deductible within such limit
 - (Presumably) Reg. §1.404(a)-14(d)(2)(i) will require that contribution be excluded from assets when determining deductible amounts for subsequent year

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IRC 404(a)(6)

- But then we 2011 Graybook Q&A 7
- A company has a calendar taxable year and sponsors a pension plan with a calendar plan year. Which of the following combinations are acceptable for a contribution made during the 2010 §404 contribution grace period (January 1, 2011 to September 15, 2011)?
 - a) Deduct in 2010, reflect on 2010 Sched SB?
 - b) Deduct in 2010, reflect on 2011 Sched SB?
 - c) Deduct in 2011, reflect on 2010 Sched SB?
 - d) Deduct in 2011, reflect on 2011 Sched SB?

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IRC 404(a)(6)

- 2011 Graybook Q&A 7 (cont)
- RESPONSE
 - a), c), and d) are acceptable. IRC §404(a)(6) deems a contribution made after the last day of a taxable year to be made on the last day of a taxable year if the payment is made on account of such taxable year. A contribution is considered to be on account of the 2011 plan year when reported on the 2011 Schedule SB and thus cannot be deducted on the sponsor's 2010 tax return

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IRC 404(a)(6)

- And similarly at the 2010 ABA Tax Section meeting IRS said:
- ... while it may be possible that the contribution can be treated in the manner proposed, the plan sponsor is not entirely free to treat it in such a manner. The contribution must be made by the deadline required by Section 404(a)(6) and the contribution must be for services performed in 2010, not 2011. The Service has traditionally looked at the regulations as providing that while the rules of Section 412 are independent from the rules of Section 404, it does not mean that the rules of Section 404(a)(6) are independent from the rules of Section 412. Thus, the treatment under Section 412 may force the treatment under Section 404, but the treatment under Section 404 does not force the treatment under Section 412. The Service representative indicated that the Service is concerned that if a plan sponsor makes the contribution in 2011, but deducts it in 2010, the contribution will not be reflected on Schedule SB before the deduction is taken. So, when the contribution for the 2011 plan year is determined, the plan's funding may look lower than it would have looked if the plan sponsor had taken that contribution into account. The result is that the contribution for the 2011 year may be artificially higher.
- Raise your hand if you DON'T have a headache after reading this gibberish!!

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IRC 404(a)(6)

- Recall also above regulation re short year in year of plan termination
 - So calendar year plan termed 10/31/19 requires MRC by following 7/15/20.
 - Applicable for 404 also per IRS??
 - i.e. calendar year taxpayer must deposited by 7/15/20 to get 2019 deduction?
- IRC 404(a)(6) and 76-28 do not require contribution to be on account of preceding plan year
- They require it to be on account of preceding tax year
- As detailed above, there is plenty of authority providing that plan year and tax year designation can be different
- If a contribution is within deductible limit for preceding tax year, and is made by due date of preceding year tax return, it should be deductible in preceding tax year irrespective of treatment for funding purposes

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IRC 404(a)(7) - more

- What if you blow combined plan limit?
- E.g. non-PBGC plan and client deposits more than 6% to DC, and DB deposit then brings total to more than 31%?
 - Client is now subject to 31% limit – i.e. once DC is more than 6% - even by a dollar - you are subject to the combined plan limit
 - Anything above 31% nondeductible and C/F to following year
 - THOUGH, if DC contribution made after year-end could push amount in excess of 6% to following year and deduct all DB
 - And then live within 31% in following year inclusive of prior year amount

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IRC 404(a)(7) - more

- So e.g. 2018 total comp. \$1,000,000
- DC deposits (maybe need for testing, safe harbor, etc.) total \$75,000; deposited in 2019
- DB deposit for 2018 = \$400,000 (w/i max)
- Deduct \$60,000 of DC (and all \$400K DB) in 2018 and remainder of DC in 2019
 - With DC needed for 2019 DC will likely again exceed 6% so will need to stay within 31% limit in 2019 – so fund as much DB cushion as possible in 2018 to minimize what needs to go into DB in 2019

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IRC 404(a)(7) - more

- Where above is not possible – e.g. DC deposits during year exceed 6% - above limit will apply as discussed above
- So deduct all DC plus DB to get to 31%
- Where DB deposits during year cause total amount to exceed 31% IRC §4972 applies

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IRC 4972

- IRC §4972 imposes excise tax equal to 10% of “nondeductible contributions”
 - Tax imposed on employer
 - Reported on Form 5330
 - IRC 4972(a) and 4972(b)
 - Tax does not apply to matching contributions that are not deductible because they exceed the combined plan limit of IRC 404(a)(7)
 - IRC 4972(c)(6)(A)

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IRC 4972

- Also, IRC 4972(c)(7):
 - “In determining the amount of nondeductible contributions for any taxable year, an employer may elect for such year not to take into account any contributions to a defined benefit plan ...”
 - How does one make such an election?
 - PIZZA PRO EQUIPMENT LEASING, INC., Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent (147 T.C. No. 14, Docket No. 13149-15, 11/17/2016)

44

IRC 4972

- Taxpayer incorrectly determined pre-62 section 415 limit when determining maximum deductible amount - **deposited and deducted excess**
- Upon audit, IRS disallowed excess deductions
- Taxpayer challenged imposition of excise tax, claiming they effectively made election under pre PPA 4972(c)(7) by NOT filing Form 5330 and paying the tax

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IRC 4972

- Court wanted more concrete evidence, pointed to line 10 on 5330, Schedule A
 - “Nondeductible section 4972(c)(6) or (7) contributions exempt from excise tax”
 - Alternatively court indicated election could be made with Form 5500
 - Attach protective election to every 5500?
 - i.e. can you make an election to not pay the tax on a contribution that you deducted but that is later disallowed?
 - I think not – would seem to me (Kevin) that to make an election you must NOT deduct the contribution

46

IRC 404(a)(6)

- **Effect of Extension.** If a company files its tax return prior to the original due date, but after obtaining an extension of time for filing, the due date under §404(a)(6) is the extended due date. Revenue Ruling 66-144, affirmed by Revenue Ruling 84-18
- Conversely, an extension is *not* valid where the return is filed *prior* to the original due date and *prior* to filing for the extension. PLR 8336006

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IRC 404(a)(6)

- Consider an employer that has a \$50,000 overpayment on their taxes when considering their pension contribution
- Refund needed for pension contribution
- Due date of tax return is 3/15
- On 3/10 extension filed until 9/15
- Return filed 3/15 claiming pension deduction
- Refund received on 4/30 and used to fund pension

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IRC 412(d)(2)

- IRC 412(d)(2):
 - "For purposes of this section, any amendment applying to a plan year which -
 - (A) is adopted after the close of such plan year but no later than 2½ months after the close of the 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..."
- How does this fit in with 404? Is increase considered for maximum?

49

IRC 412(d)(2)

- Recall 404(o)(6) "Any computation under this subsection for any plan year shall use the same actuarial assumptions which are used for the plan year under section 430 ..."
- And Reg. §1.404(a)-14(d)(1):
 - Computation of the deductible limit for plan year based on funding methods, actuarial assumptions, and benefit structure used for purposes of §412
- Graybook 2001-2 (following slides)
 - Note IRC 412(c)(8) became IRC 412(d)(2) with PPA 2006

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IRC 412(d)(2)

- 2001 Graybook Q&A 2
 - Plan A was adopted on January 1, 2000. Based on a preliminary 2000 valuation, the minimum required contribution is \$1 million and the maximum deductible amount is \$1.4 million. On February 1, 2001, the plan is amended to double benefits, effective on January 1, 2000 and made retroactive to that date. Pursuant to an election under IRC §412(c)(8), this amendment is reflected in full in the January 1, 2000 valuation. Accordingly, the minimum required contribution increases to \$2 million and the maximum deductible limit (if the plan amendment were taken into account) increases to \$2.8 million.



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IRC 412(d)(2)

- 2001 Graybook Q&A 2 (cont)
 - What is the maximum tax-deductible contribution?
 - \$2.8 million, reflecting the IRC §412(c)(8) election?
 - \$2 million: the greater of the minimum required contribution reflecting the IRC §412(c)(8) election and the otherwise applicable maximum disregarding the IRC §412(c)(8) election?
- RESPONSE
 - \$2.8 million, since any IRC §412(c)(8) election made for minimum funding purposes also applies for maximum deduction purposes.



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IRC 412(d)(2)

- But then there's 2011 Graybook Q&A 4
 - The final §430 regulations provide that a plan amendment is reflected in FT and TNC if adopted no later than the valuation date for the plan year. In the case of an amendment adopted after the valuation date, the amendment is reflected in FT and TNC if the plan administrator makes the election in §412(d)(2). However, in both cases, the amendment is taken into account only if it takes effect on or before the last day of the plan year.



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IRC 412(d)(2)

- 2011 Graybook Q&A 4 (cont)
 - Assume a discretionary amendment (i.e., an amendment that is neither required for qualification nor integral to an amendment that is required for qualification) is adopted within the §412(d)(2) period of 2 ½ months after the end of the prior plan year to increase the benefit formula for prior service for all participants that worked at any time during the prior plan year. If the plan administrator makes the §412(d)(2) election, can the amendment be reflected in FT and TNC? Does the answer depend on whether a §436 contribution is required? On whether plan operations had actually reflected the amendment in the prior year? On whether the amendment is reflected for coverage and nondiscrimination purposes?

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IRC 412(d)(2)

- 2011 Graybook Q&A 4 (cont)
- RESPONSE
 - In this situation the amendment is only reflected if it is adopted and takes effect by the end of the prior plan year. In general, if a discretionary amendment is adopted after the plan year that provides for increases in the prior year, there is no legal right to the increased benefits until adoption. Such an amendment takes effect when adopted (assuming §436 permits), and could be taken into account for the adoption year if a §412(d)(2) election is made for that year.

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IRC 412(d)(2)

- 2011 Graybook Q&A 4 (RESPONSE cont)
 - If a discretionary amendment is implemented operationally during a plan year (thus creating a legal right in the plan year) adoption is required by the end of that plan year [see Rev. Proc. 2007-44]. Any corrective amendment that meets the requirements of §1.401(a)(4)-11(g) that is adopted after the end of the plan year is treated as being effective in the year preceding the year the amendment is adopted for purposes of coverage and nondiscrimination, but that treatment will not apply for minimum funding (or deductions) as noted above.
- How did the IRS come to this conclusion? What changed??

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IRC 412(d)(2)

- Let’s look at 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.” (Emphasis added)

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IRC 412(d)(2)

- 1.430(d)-1(d) “Plan provisions taken into account” (cont)
 - (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, ***In either case, the determination of when an amendment takes effect is unaffected by an election under section 412(d)(2).***” (Emphasis added)

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IRC 412(d)(2)

- And 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....”(Emphasis added)

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IRC 412(d)(2)

- So the argument is that no legal right could exist prior to the adoption of the amendment
- See Judy Miller article from 4/14/2016 at <https://www.asppa.org/news-resources/browse-topics/where-we-stand-%C2%A7412d2-amendments>
 - “There was no acknowledgement in the final regulations that the result of a §412(d)(2) election is that the amendment is “*deemed to have been made* on the first day of such plan year” for purposes of the §412... In retrospect, the IRS’ position was clear in the regulations, but since it directly contradicted the law, it was frankly hard to believe they intended what it appeared they had said.”



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Self-employed Issues

- Special issues with respect to self-employed folks
 - IRC 404(a)(8)(C) limits deduction on behalf of SE person to such person’s earned income (determined before plan contributions) from trade or business establishing plan
 - Precludes deduction in case of MRC for DB plan to extent such amount exceeds such earned income
 - Under IRC 4972(c)(4) MRCs not deductible due to §404(a)(8) NOT subject to excise tax on nondeductible contributions



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Self-employed Issues

- What to do if MRC but no (or not enough) earned income?
 - Certainly wait until after end of year to make contribution
 - Based on above discussion should not be issue deducting in year contribution made
 - But what if there’s no income in following year either?
 - Is there carryover to subsequent years?
 - No specific carryover language in 404(a)(8)
 - There is language in IRC 404(a)(1), 404(a)(3) and 404(a)(7) indicating that amounts not deductible due to such limitations may be carried over and deducted in future years (subject to limits in such years)



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Self-employed Issues

- 1999 Graybook Q&A 13
 - A contribution is made to satisfy the minimum funding requirement. Due to net business losses, the contribution cannot be deducted because of 404(a)(8)(C), which says contributions fail to satisfy the 162 and 212 requirement if they exceed earned income
 - Can the deductions be carried over to future years? Can they be deducted up to the earned income limit in each succeeding year as contributions required to meet the minimum funding requirement of a prior plan year, or would a ten-year amortization rule be used?

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Self-employed Issues

- 1999 Graybook Q&A 13 (cont)
 - RESPONSE
 - The statute does not appear to accommodate a carryover of the 404(a)(8)(C) limit to later tax years. Section 4972(c)(4) exempts such amounts from the 10% excise tax on nondeductible contributions
- Note that others argue that carryover is available based on the language in the other sections above
- But what if there is NEVER enough earned income?

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Self-employed Issues

- But what if there is NEVER enough earned income?
- Is basis created? – Appears to be no authority
- Does tax benefit rule apply? IRC 111(a)
 - “Gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of tax imposed by this chapter.”
 - We had a recent case in our office where legal counsel and CPA were comfortable taking this position - i.e. really NOT the actuary’s call

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Self-employed Issues

- Allocating DC contributions in a partnership, Reg. §1.404(e)-1A(f)(1):
 - “... in the case of a defined contribution plan, a partner's ... distributive share of deductions allowed the partnership under section 404 for contributions on behalf of a self-employed individual is that portion of the deduction which is attributable to contributions made on his behalf ...”
 - i.e., in case of DC plan, partner simply deducts on personal tax return amounts contributed on his/her behalf

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Self-employed Issues

- Allocating DB contributions in a partnership, Reg. §1.404(e)-1A(f)(2):
 - “In the case of a defined benefit plan, a partner's distributive share of contributions on behalf of self-employed individuals and his distributive share of deductions allowed the partnership under section 404 for such contributions is determined in the same manner as his distributive share of partnership taxable income. See section 704, relating to the determination of the distributive share and the regulations thereunder.” *(Emphasis added)*

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Self-employed Issues

- IRS/ASPPA 2000 – 6
 - Q. Field Service Advice 1999-743 indicates that 1.404(e)- 1A(f)(2), which requires allocations of defined benefit plan deductions to be made in accordance with each partner's profits interest, is still valid. Is this true? Assume a partnership has three equal partners, two of whom are covered under the partnership's DB plan at a cost of \$75,000 each. There are no other employees. The 404 reg appears to say that each partner is responsible for funding (and deducting) \$50,000.
 - A. Absent a special allocation in the partnership agreement we agree with the above result. A special allocation in the partnership agreement could result in the deduction being allocated to the two covered employees.

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Self-employed Issues

- Not being lawyers, we're hesitant to opine on what the partnership agreement, written or oral, would have to say
- From IRS Publication 541
 - "The partnership agreement includes the original agreement and any modifications. The modifications must be agreed to by all partners or adopted in any other manner provided by the partnership agreement. The agreement or modifications can be oral or written."

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Self-employed Issues

- In the recent case of Bruner v IRS [TCM 2018-10 David L. Bruner v Comr IRS, Docket 13651-16 (1/30/18)], the partnership agreement did not provide for special allocations of the pension deduction. Further, numerous modifications to the agreement were made without mentioning allocation of the pension deduction. Nevertheless the Service allowed verbal and other written evidence to be a de facto modification and allowed the special allocation.
 - Case was in court for other reasons

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A Closer Look at IRC 404 and 430

- Mortality – Age 62 immediate annuity factor, 5.5% interest, 417(e)(3) purposes
- | Year | Factor |
|------|---------|
| 2017 | 12.506 |
| 2018 | 12.8755 |
| 2019 | 12.833 |
- 417(e)(3) mortality is unisex based on 50% male and 50% female tables used for funding
 - Why? 2018 mortality tables were updated (every 10 years, RP-2014) based on more recent experience (For 2018, can still use prior tables). All of the above are based on static tables, which factor in expected mortality improvements. Mortality for 2019 is based on IRS Notice 2018-02. Mortality for 2018 is based on IRS Notice 2017-60. For 2019, modest decrease because updated mortality tables were overly optimistic in projecting improvements

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A Closer Look at IRC 404 and 430

- Automatic Approval for a Change in Funding Method, Revenue Procedure 2017-56
- Why is this important? \$10,000 User Fee to file for a specific IRS approval for a Change in Method, procedure is described in Revenue Procedure 2017-57
- Revenue Procedure 2017-56 replaces Revenue Procedure 2000-40 (modifies Announcements 2010-3 and 2015-3) and considers the following:
 - Change in asset valuation method
 - Changes in valuation date
 - Change in funding method for takeover plans (most used?)
 - Change in method due to change in valuation software
 - Change in method due to change in selection of data elements
 - Change in method for fully funded terminated plans
 - Plan mergers, not thoroughly covered in this presentation
 - Restrictions on Use of Automatic Approval
 - Effective Date – Generally 2018 Plan Years

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A Closer Look at IRC 404 and 430

- Asset Valuation Changes, changes allowed:
 1. Change to Fair Market Value
 2. Change to an Average of Fair Market Values as described IRS Notice 2009-22 (Note that the method cannot result in a value of assets that is not greater than 110% or less than 90% of fair market value)
 3. Change to a Method that applies a phase-in for the value of Plan assets, a new method from the Revenue Procedure

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A Closer Look at IRC 404 and 430

- Changes in Valuation Date
 1. Only allows change to first day of the Plan Year
 2. If the Plan Year changes and the last day of the Plan year was the prior valuation date, the Plan can continue to use last day of the Plan Year
- Stay tuned, change to last day of the Plan year is permitted for takeovers
- For asset valuation and valuation date changes, Sponsor must indicate approval on IRS Form 5500 series filing

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A Closer Look at IRC 404 and 430

- Takeover Plans, automatic approval if
 1. Both the enrolled actuary and the business organization providing services have changed
 2. The new method is the same as the method used by the prior actuary and is consistent with the description in the prior Schedule SB
 3. The funding target and target normal cost (without regard to adjustments for Plan expenses) as determined by the new Enrolled Actuary as of the valuation date for the prior plan year (using the actuarial assumptions of the prior enrolled actuary) are both within 3% of those values determined for that prior year by the prior actuary
 4. The actuarial value of assets as determined by the new enrolled actuary are with 2% of the value determined by the prior actuary

The comparisons in 3 and 4 can be based on a current year valuation, if available.



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A Closer Look at IRC 404 and 430

- Approval for Change in Software
- If all results of each specific computation method are the same after the change in valuation software, there is no change in funding method.
- If the results are not the same and:
 1. The actuary is the same OR the business organization is the same as the prior plan year
 2. The new method is substantially the same as the method for the prior year
 3. The new valuation software will be used by the single employer plans to which the actuary will be providing services
 4. For either the prior year or the current year, the funding target and target normal cost are within 1%, the 1% is increased to 2% if similar approval was not used for the prior year
 5. The "new" valuation software is designed to produce results that are no less accurate than the prior results



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A Closer Look at IRC 404 and 430

- Approval for change in funding method due to change in selection of data elements if the 4 items below are satisfied:
 1. The actuary is the same OR the business organization is the same as the prior plan year
 2. Other than the change in data elements described in this approval, the new method is the same
 3. The funding target and target normal cost determined using the new data elements are each within 1% of the values determined using the prior data elements
 4. The use of any new data element is designed to produce results that are no less accurate than the results produced previously

Example: A change from using prior years' actual compensation with an adjustment to the current valuation date to using the current annual rate of pay would be approved if the conditions are satisfied.



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A Closer Look at IRC 404 and 430

- Approval for change in funding method for fully funded terminated plans as described in 1 is approved if the conditions in number 2 (see next slide) are satisfied
- 1. Any of all of the following changes in funding method may be made:
 - the asset valuation method may be changed to a fair market value method even if the change would not be approved under the change in asset valuation method
 - the valuation date may be changed to the Plan termination date or the first day of the Plan year
 - the funding method may be changed as a result of a change in both the enrolled actuary and business organization providing services to the plan, even if not otherwise approved under the takeover rules
 - the funding method may be changed as a result of a change in the valuation software, even if not otherwise approved
 - the funding method may be changed as a result of a change in data elements, even if not otherwise approved

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A Closer Look at IRC 404 and 430

- Approval for change in funding method for fully funded terminated plans (continued)
- 2. As of the date of termination, the assets of the plan (exclusive of contributions receivable) are sufficient to cover all benefit liabilities and the PBGC filing was made timely.
- May not need Automatic Approval → Irrespective of funded status, if a calendar year plan using a 12/31 val date terminated on 12/30 the val date can be changed to any date from 1/1-12/30. Reg 1.430(a)-1(b)(5)(ii)
- Mergers – beyond the scope of this presentation

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A Closer Look at IRC 404 and 430

- Restrictions on Use of Automatic Approval
 - Approval does not apply unless the Plan Administrator or an authorized representative indicates on the 5500 series return filed for the plan that the plan administrator or plan sponsor agrees to the change in funding method for Change in asset valuation method or change in valuation date
 - For other approvals, the plan administrator must be made aware before the Schedule SB is filed
 - The Plan cannot have a minimum funding waiver or have an application pending
 - The Plan cannot be under an Employee Plans examination
 - There are additional restrictions in the case of a Plan Merger

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A Closer Look at IRC 404 and 430

- Questions?
