IRS

Employee Plans Webinar

# Defined Benefit Plan Terminations

# Presenters

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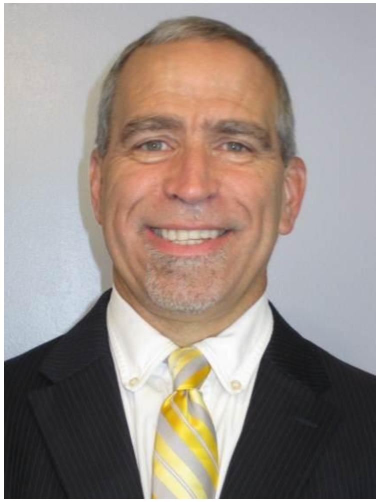

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# Retirement Plans

**Benefit Practitioner**

**Plan Participant, Employee**

**Plan Sponsor**

**Topics for Retirement Plans**

- IRAs
- Types of Retirement Plans
- Required Minimum Distributions
- Retirement Plan FAQs
- Published Guidance
- Forms & Publications
- Correcting Plan Errors
- Newsletters
- More Topics

## Tax Information for Retirement Plans Community

**Help with Choosing a Retirement Plan**
Web guide to help you compare plans

**File a Retirement Plan Return**
Forms 5500, 5500-SF, 5330, 5558 and 8955-SSA

**Form 2848 - More Changes**
Use the March 2012 version to designate a representative for retirement plan issues.

**Retirement Plans Phone Forums**
Check out upcoming phone forums

**Fix-It Guides**
Find, Fix and avoid common mistakes in plans

**Cost-of-Living Adjustments (COLAs)**
Limits on contributions and benefits

**Examinations and Enforcement**
Audit guide, compliance check letters and other programs

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Stay informed; choose your interest…

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**“All’s well that ends well.”**

— William Shakespeare, *All’s Well That Ends Well*

# Topics Covered

- Plan Terminations
- Plan Funding / Funding & Reversions
- PBGC
- Notice of Intent to Terminate the Plan

# Plan Terminations

# IRS Concerns with Plan Termination

- Accelerated vesting - IRC § 411(d)(3)
- Accrual requirements - IRC § 411(b)
- Funding obligations - IRC § 412
- Reversion of assets to the employer (maybe excise tax - IRC § 4980)
- Continuing § 401(a) compliance - Revenue Ruling 89-87

# Statutory Authority

- Regulations Section 1.416-1, T-4
  - defines terminated plan
  - distribution of assets should be made as soon as administratively feasible
  - administratively feasible = 1 year

# What Happens with a Termination

- The date of termination must be set
- The participants' benefits and other liabilities, must be determined up to the date of termination
- All plan assets must be distributed per the plan and as soon as administratively feasible

# DB Plan Termination

PBGC → responsible for administering ERISA Title IV

When is a DB Plan terminated? → depends on whether plan is covered by ERISA Title IV

- DB plan is covered by Title IV if it has:
  - a favorable DL from IRS or
  - in practice satisfied the qualification requirements of IRC § 401(a) for the preceding 5 plan years

# DB Plan Termination

- If covered by Title IV
  - must comply with the procedures under ERISA § 4041
- If not covered by Title IV
  - effective termination date stated in the ERISA § 204(h) notice
  - If ERISA § 204(h) is not applicable, termination date is in employer adopted resolution

# Date of Termination

- Fixes the date that benefits stop accruing
- Fixes value of assets
- Distributions –commence as soon as administratively feasible, accrued benefits are fully vested
- Date plan document to be updated through
- Sets final plan year for minimum funding

# Title IV Date of Termination

- The termination date is established by:
  - standard termination – plan administrator
  - distress termination – plan administrator and agreed to by PBGC
  - involuntary termination – PBGC and agreed to by the plan administrator or court

# Standard Termination

- Plan has enough assets to pay benefits
- ER files PBGC *Form 500 & Schedule EA-S*
- Participants receive 60 day notice
- PBGC has 60 days to review termination for compliance

# Distress Termination

- A plan without enough assets to pay all benefits owed the participants and or beneficiaries.

# Distress Termination

- Plan sponsor can initiate a distress termination by meeting one of these ERISA distress tests:
  - Reorganization Distress Test
  - Business Continuation Distress Test
  - Liquidation Distress Test
  - Pension Cost Test

# Reorganization Distress Test

- A company must be in bankruptcy reorganization or insolvency proceedings; and
- Bankruptcy court must find that unless the plan terminates, the company cannot pay all its debts under a plan reorganization

# Business Continuation Distress Test

- The company must demonstrate to PBGC that unless a distress termination happens, the company cannot:
  - pay its debts when due; and
  - continue in business

# Liquidation Distress Test

- The company must have filed or had filed against it, a petition seeking liquidation under federal or state law which has not been dismissed

# Pension Cost Test

- The company must show the PBGC (to their satisfaction) the company's cost of providing the pension benefits have become burdensome solely as a result of declining covered employment

# Distress Termination Declined

- If a plan does not qualify for a distress termination PBGC will let the ER know they don’t meet the conditions and the plan will remain ongoing and monitored by PBGC

# Distress Termination Granted

- ER must file PBGC *Form 601 with Schedule EA-D* on or before the 120th day after the proposed termination
- A 60 day advance notice is required to be given to the affected participants

# Notice to Interested Parties

- Pension plan administrators must notify plan participants and alternate payees of any amendment that significantly reduces the rate of future benefit accruals

# Notice to Interested Parties

- The notice must be delivered to interested parties as described in Reg. § 1.7476-2(c).
  - sent via electronic medium
  - delivered in person
  - posting to bulletin board
  - delivered by mail

# Frozen Plan

- Not terminated
- Future benefits cease to accrue
- If underfunded, likely frozen not terminated
- Still subject to qualification
- Some exceptions with respect to
  - minimum coverage § 410(b)
  - participation requirements of § 401(a)(26)

# Wasting Trust

- Plan terminated
- Assets not distributed within “administratively feasible” time
- Plan considered still active
- File Form 5500

# Plan Funding / Reversions

# Minimum Funding

- Still applies through year of termination
- Funding standard account is maintained through year of termination
- Does not apply for years after termination
- Does not relieve unpaid minimums
- May be a proration of funding (target normal cost, amortization installments) for partial years

# Employer Reversion

- The amount of cash and the fair market value of other property received by an employer from a qualified plan

# Reversion – Excise Taxes

- 50% excise tax
- 50% may be reduced to 20% if:
  - Chapter 7 Bankruptcy
  - Plan amended to increase benefits 20%
  - 25% of excess assets transferred to new plan – like 401(k)

# Reversions

- Termination/Reestablishment and Spinoff/Termination
  - Treated same as reversion
  - 414(l)(2) – allocation of assets in spinoff, etc must be satisfied
    - Must allocate % of surplus to spinoffs

# Reversion – Termination/Reestablishment

- A termination/reestablishment occurs when:
  - Plan is terminated
  - Assets are distributed or annuities purchased
  - A new defined benefit plan is established
  - Employer receives reversion

# Reversion – Spinoff/Termination

- A spinoff/termination occurs when:
  - A defined benefit plan is split into two (or more) plans:
    - One for retirees – with surplus assets
    - One for actives
  - Retiree plan is terminated
  - Employer receives a reversion

# Reversion – Implementation Guidelines

- All benefits were vested upon termination
- Accrued benefits – annuity purchases or lump sums provided to all
- No distributions to active employees covered by the ongoing portion of the plan who have not attained NRA
- All employees notified of termination in advance

# Overfunded Plans – Limited Circumstances

- Contributions can't be returned to the employer once they've been made, except in these limited circumstances:
  - mistake of fact,
  - disallowance of deduction,
  - plan fails to initially qualify under IRC § 401(a), or
  - reversion of assets upon plan termination

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# Overfunded Plans – Reversion of Surplus Assets

- Before surplus assets can revert to the employer, the plan terms must allow it.
- If reversion is from defined benefit plan:
  - plan terms must have permitted it for 5 calendar years before the termination date
  - the reversion must have been due to an "erroneous actuarial computation" under Treas. Regs. § 1.401-2

# Overfunded Plans - IRC § 4980
# Excise Tax on the Reversion

- In addition to any income taxes due:
  - employer must file Form 5330 and pay excise tax on the last day of the month following the month of the reversion
  - excise tax = 20% of amount reverted back to the employer from a qualified plan (IRC § 4980)

# Underfunded Plans

- For an underfunded plan to terminate via a standard termination, there are two options:
  - provide supplemental employer contributions to make the plan whole
  - forego benefits for the majority owner

# Overfunded Plans – Supplemental Employer Contributions

- The employer may make a sufficient contribution to the plan prior to distribution so the assets equal the amount of the liabilities

# Underfunded Plan – Forego Benefits

- An underfunded plan may permit:
  - a participant who is a majority owner in excess of 50% of the employer (with spousal consent) to “forego receipt” of all or part of his benefit until all other participants’ liabilities are met, or
  - assets to be allocated upon plan termination on a pro rata basis

# Overfunded Plans – Waiver of Benefits

- A participant cannot "waive" his or her accrued benefit. This violates IRC Sections 411(d)(6), 411(a) & 401(a)(31)
- Plan amendment waivers violate the Code's prohibition against the reduction of an accrued benefit by plan amendment

# Pension Benefit Guaranty Corporation

# PBGC

- The Pension Benefit Guaranty Corporation (PBGC) administers Title IV of ERISA
- Guarantees certain level of benefits for terminating defined benefit plans

# PBGC

- Notable plans *not* covered
  - professional service employers with no more than 25 plan participants
  - Plans covering only substantial owners
  - Governmental, Church, and Defined Contribution Plans

# PBGC Plan Requirements

- Make annual premium payments
  - Fixed and “variable” for underfunded
  - Filed with the Form 1 (electronic starting in 2010)
- Disclose reportable events
  - Failure to pay benefits
  - Liquidation

# PBGC Plan Requirements

- Give a Notice of Intent to Terminate
- File PBGC Form 500 (Standard Term Notice) and Schedule EA-S (Standard Term Certification of Sufficiency)
  - Due 180 days after proposed termination date

# IRS Audits & PBGC

- Terminations should be in process with the PBGC – coordinate with them
- Form 1 premiums should have been filed
- Review Notice of Intent to Terminate for timeliness and required content.
- Determine if a referral to the PBGC is warranted.  Form 6533 - *Examination Referral Checklist*

# Notice of Intent to Terminate the Plan

# Written Notice of Intent to Terminate

- Written Notice must be issued to all affected parties at least 60 days and no more than 90 days before the proposed termination date.
- 204(h) Notice – amendment to significantly reduce the rate of future benefit accruals. Must be given to plan participants 15 days before the effective date of the amendments.

# IRS – Form 5310

- Use Form 5310, Application for Determination for Terminating Plan, to apply for a determination letter upon termination of a plan

# IRS – Submission Requirements

- Form 8717 with user fee
- Copies of (if applicable):
  - Complete plan document(s) and all amendments since last favorable DL
  - Last favorable DL
  - Latest opinion or advisory letter
  - Records of actions taken to terminate the plan
  - Required attachments and statements

# Timeliness of Application

- File Form 5310 by the later of one year from:
  - the effective date of the termination, or
  - the adoption date of the resolution to terminate the plan

# IRS – Why File?

- Assurance for trustees transferring assets
- Extension to distribute prior to PBGC notification
- Some certainty plan is qualified upon termination
- Helps identify any issues prior to distribution
- Proof for IRAs that rollover from qualified plan
- Prevents potential issues for plans with excess assets (overfunded)

# DOL – Form 5500

- The employer must continue to file the Form 5500, Annual Report of Employee Benefit Plans, until all the assets of the trust have been distributed