Part III – Administrative, Procedural and Miscellaneous

Plan Amendments Following Election of Alternative Deficit Reduction Contribution

Notice 2004-59

This notice provides guidance on the restrictions that are placed on plan amendments following an employer's election of the alternative deficit reduction contribution under § 412(l)(12) of the Internal Revenue Code (the "Code") and section 302(d)(12) of the Employee Retirement Income Security Act of 1974 ("ERISA"), as added by section 102 of the Pension Funding Equity Act of 2004, Pub. L. 108-218 ("PFEA '04").

I. Background

Section 102 of PFEA '04, which was enacted on April 10, 2004, added § 412(l)(12) to the Code and section 302(d)(12) to ERISA. Section 412(l)(12) of the Code permits certain employers who are required to make additional contributions under § 412(l) to elect a reduced amount of those contributions ("alternative deficit reduction contributions") for certain plan years. An employer is eligible to make such an election if it is (1) a commercial passenger airline, (2) primarily engaged in the production or manufacture of a steel mill product or the processing of iron ore pellets, or (3) an organization described in § 501(c)(5) that established a plan on June 30, 1955, to which § 412 now applies. On April 12, 2004, the Internal Revenue Service (the "Service") issued Announcement 2004-38, 2004-18 I.R.B. 878, which provides guidance for making the election for an alternative deficit reduction contribution. On May 6, 2004, the Service issued Announcement 2004-43, 2004-21 I.R.B. 955 (corrected by Announcement 2004-51, 2004-23 I.R.B. 1041), which provides further guidance for making the election for the alternative deficit reduction contribution and provides guidance regarding notices that must be provided to participants, beneficiaries, and the Pension Benefit Guaranty Corporation following the making of the election.

Section 412(l)(12)(B) provides that no amendment that increases the liabilities of the plan by reason of any increase in benefits, any change in the accrual of benefits, or any change in the rate at which benefits become nonforfeitable under the plan shall be adopted during any applicable plan year, unless (1) the plan's enrolled actuary certifies (in such form and manner prescribed by the Secretary) that the amendment provides for an increase in annual contributions that will exceed the increase in annual charges to the funding standard account attributable to such amendment, or (2) the amendment is required by a collective bargaining agreement that is in effect on April 10, 2004. Section 412(l)(12)(B) further provides that, if a plan is amended during any applicable plan year (i.e., a plan year for which the § 412(l)(12) election is

made) in violation of the preceding sentence, any election under § 412(l)(12) shall not apply to any applicable plan year ending on or after the date on which the amendment is adopted.

Section 302 of ERISA contains minimum funding standard requirements that are parallel to those under § 412 of the Code, and section 302(d)(12) of ERISA provides an election that is identical to the election under § 412(l)(12) of the Code. Under section 101 of Reorganization Plan No. 4 of 1978, 1979-1 C.B. 480, the Secretary of the Treasury has sole interpretive authority over the interpretation of section 302(d)(12) of ERISA. Accordingly, the guidance set forth in this notice applies as well under section 302(d)(12) of ERISA.

Section 412(c)(12) of the Code provides that, in determining projected benefits, the funding method of a collectively bargained plan (other than a multiemployer plan) shall anticipate benefit increases scheduled to take effect during the term of the collective bargaining agreement applicable to the plan.

Section 1.412(c)(3)-1(d)(1)(i) of the Income Tax Regulations provides that, except as otherwise provided by the Commissioner, a reasonable funding method does not anticipate changes in plan benefits that become effective, whether or not retroactively, in a future plan year or that become effective after the first day of, but during, a current plan year.

Rev. Rul. 77-2, 1977-1 C.B. 120, provides guidance regarding the minimum funding requirements with respect to a change in the benefit structure of a qualified pension plan that becomes effective during a plan year. Section 2.02 of Rev. Rul. 77-2 provides that, in the case of a change in the benefit structure that becomes effective as of a date during a plan year (but subsequent to the first day in such plan year), the charges and credits to the funding standard account shall not reflect the change in such benefit structure for the portion of such plan year prior to the effective date of such change, and shall reflect the change in such benefit structure for the portion of the plan year subsequent to the effective date of the change. Section 3 of Rev. Rul. 77-2 provides that, in determining the charges and credits for the plan year, in lieu of using the rule of section 2.02, a plan is permitted to disregard a change in benefit structure that is adopted after the valuation date for the year.

Section 412(c)(8) provides that any amendment applying to a plan year that is adopted after the close of the plan year but no later than 2½ months after the close of the plan year and that does not reduce the accrued benefit of any participant determined as of the beginning of the first plan year to which the amendment relates shall, at the election of the plan administrator, be deemed to have been made on the first day of such plan year (subject to additional restrictions on plan amendments that reduce benefits). Pursuant to Rev. Proc. 94-42, 1994-1 C.B. 717 and Rev. Rul. 79-325, 1979-2 C.B. 190, § 412(c)(8) also applies to plan amendments adopted during the plan year to which the amendment relates.

II. Questions and Answers Regarding Plan Amendments Following a § 412(l)(12) Election

Q-1. Which plan amendments are subject to the requirements of § 412(l)(12)(B) (regarding plan amendments increasing benefits)?

A-1. Plan amendments that are subject to the requirements of § 412(l)(12)(B) are referred to in this notice as "restricted amendments". A plan amendment is a restricted amendment if it is adopted during a plan year for which an election for an alternative deficit reduction contribution is in effect, is not required by a collective bargaining agreement in effect on April 10, 2004, and increases benefits (including an increase in an early retirement benefit or retirement-type subsidy), changes the accrual of benefits in a manner that results in increased accruals, or changes the rate at which benefits become nonforfeitable in a manner that results in faster vesting. Thus, for example, with respect to a plan not maintained pursuant to a collective bargaining agreement, a plan amendment adopted February 1, 2004, and providing a benefit increase effective during the 2004 calendar plan year is a restricted amendment if the employer makes an election for an alternative deficit reduction contribution for the 2004 plan year. Furthermore, if that employer makes an election for the alternative deficit reduction contribution for the 2005 plan year, the plan amendment adopted in 2004 will continue to be a restricted amendment for the 2005 plan year. For purposes of determining whether a plan amendment is a restricted amendment, a plan amendment is considered adopted at the later of the time it is adopted or made effective. Thus, a plan amendment with different benefit increases that become effective during different plan years is considered adopted during each plan year in which each benefit increase becomes effective (if no earlier than the date on which the amendment is added to the plan).

A plan amendment adopted during a plan year for which the employer did not make an election for the alternative deficit reduction contribution (or a plan amendment considered adopted during such a plan year) is not a restricted amendment for the plan year adopted or for the subsequent plan year, even if the employer makes an election for an alternative deficit reduction contribution for the subsequent plan year. However, such a plan amendment will be considered adopted during the subsequent plan year for purposes of determining whether the amendment is a restricted amendment unless an election is made under § 412(c)(8) to treat the plan amendment as made on the first day of the plan year in which adopted and unless the amendment is treated as effective as of the beginning of the plan year.

Annual cost-of-living adjustments to statutory limits that are implemented pursuant to plan terms that are adopted and in effect before the beginning of the plan year for which the alternative deficit reduction contribution election is made are not treated as plan amendments that are subject to the requirements of § 412(l)(12)(B). Thus, annual cost-of-living adjustments to the § 401(a)(17) limit and the § 415(b)(1)(A) dollar limit that are automatically put into effect pursuant to plan terms that are

adopted and in effect before the beginning of the plan year are not treated as restricted amendments.

Q-2. What plan terms must a restricted amendment include?

A-2. A restricted amendment must include terms that require that contributions to the plan for all plan years in which the alternative deficit reduction contribution election is in effect will exceed the § 412(l)(12)(B) amount described in Q&A-3 of this notice. A restricted amendment may satisfy this requirement by reflecting the formula for the § 412(l)(12)(B) amount set forth in Q&A-3 of this notice. Alternatively, a restricted amendment may satisfy this requirement by providing for a dollar amount of contributions or for some other method of determining contributions if the amount of contributions specified in the plan exceeds the § 412(l)(12)(B) amount. For this purpose, the terms of a collective bargaining agreement pursuant to which a plan is maintained are deemed included in plan terms.

If a restricted amendment is adopted prior to August 31, 2004, the plan complies with this Q&A-2 if, no later than October 31, 2004, the plan is amended to provide for contributions that exceed the § 412(l)(12)(B) amount.

Q-3. How is the § 412(l)(12)(B) amount determined?

A-3. The § 412(l)(12)(B) amount is equal to the sum of the minimum required contribution under § 412 determined as if the restricted amendment had not been made (taking into account the alternative deficit reduction contribution election) plus the incremental amendment amount. The incremental amendment amount is equal to the difference between the required minimum contribution under § 412 that would have been due taking into account the restricted amendment and the required minimum contribution under § 412 that would have been due disregarding the restricted amendment. These two calculations are made as if the alternative deficit reduction contribution had not been elected. The calculation of the required minimum contribution under § 412 that would have been due taking into account the restricted amendment generally is made as if the amendment had been adopted and made effective on the first day of the plan year (i.e., the amendment must be fully reflected in plan costs for this purpose). However, if the amendment does not provide for benefit increases attributable to service prior to the beginning of the plan year, and is not effective as of the first day of the plan year, the amendment may instead be treated in accordance with the rules of section 2.02 of Rev. Rul. 77-2. In addition, the rules of § 412(c)(12) apply to the determination of the § 412(l)(12)(B) amount. For rules regarding the treatment of a credit balance generated as a result of contributions made with respect to the § 412(l)(12)(B) amount for the prior plan year, see Q&A-5.

The § 412(l)(12)(B) amount is computed without regard to any funding waiver for the plan year. Accordingly, the terms of a restricted amendment do not comply with § 412(l)(12)(B) if, under the terms of the plan as amended by the restricted

amendment, any portion of the contribution in excess of the incremental amendment need not be made if a funding waiver is granted.

Q-4. How does the § 412(l)(12)(B) amount affect the application of the minimum funding requirements of § 412?

A-4. The § 412(l)(12)(B) amount does not affect the computation of minimum required contributions under § 412. Thus, for example, quarterly contributions under § 412(m) are not required to reflect the minimum contribution required to maintain the applicability of the alternative deficit reduction contribution election. If an amount in excess of minimum required contributions is contributed for a plan year on account of the § 412(l)(12)(B) amount, the plan's funding standard account will reflect a credit balance on account of the excess. In addition, even if an amendment is considered adopted in a later year or years for purposes of determining whether an amendment is a restricted amendment for a plan year for purposes of applying § 412(l)(12)(B), the rules of § 412(c)(12) (requiring the funding method of a collectively bargained plan to take into account certain anticipated benefit increases) may require the amendment to be taken into account at an earlier time for purposes of computing minimum required contributions under § 412.

Q-5: How does a credit balance generated as a result of contributions made with respect to the § 412(l)(12)(B) amount for the prior plan year affect the computation of the § 412(l)(12)(B) amount for the plan year?

A-5: If a restricted amendment was adopted in a prior plan year for which the alternative deficit reduction contribution election was made, the credit balance resulting from the excess of the § 412(l)(12)(B) amount for the prior plan year over the minimum required contribution for the prior plan year must be disregarded in computing the § 412(l)(12)(B) amount for the current plan year. Thus, for example, assume that an employer elects the alternative deficit reduction contribution for both the 2004 and 2005 calendar plan years, adopts a restricted amendment during the 2004 plan year, and contributes the § 412(l)(12)(B) amount for the 2004 plan year, creating a credit balance as of the end of the 2004 plan year. The determination of the § 412(l)(12)(B) amount for the 2005 plan year (which reflects the restricted amendment adopted in 2004 as well as any restricted amendments adopted in 2005) is made as if there were no credit balance resulting from the excess of the § 412(l)(12)(B) amount for the 2004 plan year over the minimum required contribution for the 2004 plan year. However, if the contributions made for the 2004 plan year exceed the § 412(l)(12)(B) amount for that plan year, the credit balance attributable to that excess can be taken into account in determining the § 412(l)(12)(B) amount for 2005.

Q-6. How does the plan's enrolled actuary certify that a restricted amendment provides for an increase in annual contributions that will exceed the increase in annual charges to the funding standard account attributable to such amendment?

A-6. The plan's enrolled actuary certifies that a restricted amendment provides for an increase in annual contributions that will exceed the increase in annual charges to the funding standard account attributable to such amendment by filing a certification with the Service that, following the adoption of the plan amendment, the plan includes terms to the effect that contributions to the plan while the alternative deficit reduction contribution election is in effect will exceed the § 412(l)(12)(B) amount described in Q&A-3 of this notice. The certification may be based either on plan terms incorporating the formula described in Q&A-3 or on plan terms providing for either an amount of contributions or an alternative formula for contributions under which contributions for the plan year will exceed the § 412(l)(12)(B) amount. The certification must also provide the derivation of the § 412(l)(12)(B) amount as well as the amount of contributions required under the terms of the plan (if determined under an alternative formula).

The certification with respect to a restricted amendment made during a plan year must be filed on or before the due date for the filing of Form 5500 for the plan year at the following address:

Internal Revenue Service
Commissioner, Tax Exempt and Government Entities Division
Attention: SE:T:EP:RA:T
Alternative DRC Election Amendment Certification
P.O. Box 27063
McPherson Station
Washington, D.C. 20038

Q-7. What are the consequences of failure to include the plan terms required under § 412(l)(12)(B) as part of a restricted amendment?

A-7. If a restricted amendment does not contain the plan terms required under § 412(l)(12)(B) in a plan year, then the alternative deficit reduction contribution election is no longer valid for the plan year and cannot be made in any succeeding plan year.

Q-8. What are the consequences of failure to contribute the amount required under a restricted amendment that includes plan terms that satisfies the plan language requirements of § 412(l)(12)(B)?

A-8. If the contribution required under the terms of a restricted amendment is not made on or before the due date for contributions for the plan year, then the alternative deficit reduction contribution election is no longer valid for the plan year and cannot be made in any succeeding plan year.

Paperwork Reduction Act

The collection of information contained in this notice has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1889.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information in this notice is in Q&A-6. This information is required to meet the requirements of section 102 of the Pension Funding Equity Act of 2004 to monitor and make valid determinations with respect to employers that elect an alternative deficit reduction contribution for certain plans and make restricted amendments. As a result of such elections, an employer's deficit reduction contribution for certain plans will be based on amounts specified under § 412(l)(12) of the Code. The likely respondents are businesses or other for-profit institutions, and nonprofit institutions.

The estimated total annual reporting and/or recordkeeping burden is 400 hours.

The estimated annual burden per respondent/recordkeeper varies from 3 to 5 hours, depending on individual circumstances, with an estimated average of 4 hours. The estimated number of respondents and/or recordkeepers is 100.

The estimated frequency of responses is occasional.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. § 6103.

Drafting Information

The principal authors of this notice are James E. Holland of the Employee Plans, Tax Exempt and Government Entities Division and Linda S. F. Marshall of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). Mr. Holland may be reached at 202-283-9699. (not a toll-free number).