



Pension Analyst

Important information

Plan administration and operation

March 2011

IRS issues funding relief guidance for single-employer plans

Who's affected

These developments affect sponsors of and participants in single-employer and multiple employer defined benefit plans. They do not affect multiemployer plans, governmental plans or church plans that do not elect to be covered by ERISA ("non-electing church plans"). A separate publication discusses guidance affecting [multiemployer plans](#).

Background and summary

On June 25, 2010, President Obama signed into law the "Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010" ("[PRA 2010](#)"). This new law provided funding relief for single-employer and multiple employer defined benefit plans, in response to the unstable economic environment and continued market volatility. Specifically, PRA 2010 provides plan sponsors several options to extend the funding amortization periods in any two plan years during the 2008-2011 period.

At the same time, the IRS published Notice 2010-55 which promised future guidance with respect to PRA 2010 funding relief and special rules for Form 5500 filings.

Recently, the IRS published [Notice 2011-3](#), which describes the funding relief provided by PRA 2010 and also discusses the guidance anticipated in [Notice 2010-55](#). In addition to the guidance regarding the extended funding amortization periods, Notice 2011-3 provides guidance regarding:

- Excess compensation amounts;
- Mergers and acquisitions;
- Elections to use an alternative amortization schedule;
- Notification to participants, beneficiaries and the Pension Benefit Guaranty Corporation (PBGC);
- Form 5500 reporting requirements; and
- Transition rules.

This *Pension Analyst* discusses the guidance provided in Notice 2011-3 in an effort to help plan sponsors determine the future actions necessary to obtain funding relief.

Action and next steps

The provisions of PRA 2010 are effective for plan years beginning after December 31, 2007. Plan sponsors should carefully read the guidance discussed in this *Pension Analyst*. If you have any questions about the information discussed in this publication, you should contact the plan's enrolled actuary.

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General rules

Plan sponsors may elect one of two alternative amortization schedules for one or two eligible plan years. An “eligible plan year” is any plan year beginning in 2008, 2009, 2010 or 2011, provided the due date for the payment of the minimum required contribution occurs after June 25, 2010. In general, plan years ending on or after October 10, 2009, and beginning before January 1, 2012, are eligible for the relief.

A plan sponsor may elect to apply either the:

- [Two plus seven-year amortization schedule](#); or
- [15-year amortization schedule](#).

A plan year for which such an election is made is known as an “election year.” If an election is made to use an alternative amortization schedule for two eligible plan years, the same amortization schedule must be used for both years.

The notice provides several examples how to calculate installment amounts under both alternative amortization schedules and what interest rate should be used. It also provides guidance regarding the calculation of installments if the valuation date is not the first day of the plan year.

Impact on funding waivers

An election to use an alternative amortization schedule may affect the plan sponsor’s ability to obtain a funding waiver. The IRS reviews each funding waiver based on the facts and circumstances applicable to the plan. One relevant factor is whether the combination of a funding waiver and an election to use an alternative amortization schedule would reduce the minimum required contribution to such an extent that the granting of the waiver would adversely impact the interest of the plan participants.

To ensure that the granting of the waiver does not adversely impact the interest of plan participants, the IRS may impose additional requirements relating to the election of an alternative amortization schedule as a condition for the approval of a funding waiver.

Installment acceleration amount

Plan sponsors that elect either the two plus seven-year rule or the 15-year rule must comply with the “cash flow rule.” Under the cash flow rule, a plan sponsor that elects to extend the funding shortfall amortization period must make additional contributions to the plan. This additional contribution is known as the “installment acceleration amount” which is the total amount of:

- [Excess employee compensation](#) for all employees for the plan year; plus
- [Extraordinary dividends and stock redemptions for the plan year](#).

The installment acceleration amount applies during the “restriction period” which is:

- Three plan years if the 2 plus 7-year rule is elected; or
- Five plan years if the employer elects the 15-year rule.

The restriction period begins on the first day of the later of the:

- Plan year for which the relief is elected; or
- First plan year beginning after December 31, 2009.

Example: If the sponsor of a calendar-year plan elects to use the 2 plus 7-year amortization schedule for the plan year beginning in 2011 (the 2011 election year), the restriction period would be the 3-year period beginning January 1, 2011, and ending December 31, 2013. If the plan sponsor elects to use the 15-year amortization schedule with a 2011 election year, the restriction period would be the 5-year period beginning January 1, 2011, and ending December 31, 2015.

Installment acceleration amounts are intended to accelerate the timing of amortization installments. The notice provides examples regarding the calculation of the:

- Installment acceleration amount; and
- Annual limit imposed on the amortization installment.

If the amortization installment exceeds the annual limit for a plan year, the excess is carried over and added to the increase in the amortization installment for the following plan year. Any excess installment acceleration amount is carried over for each plan year until there is no longer an excess installment acceleration amount. However, an excess amount cannot be carried over to a plan year that begins after the:

- First plan year following the last plan year in the restriction period using the 2 plus 7-year amortization schedule; or
- Second plan year following the last plan year in the restriction period using the 15-year amortization schedule.

If a plan sponsor elects relief for two plan years, the cash flow rule applies twice. For example, if there was excess compensation and dividends of \$2,000,000 for a given year and relief had been elected twice, that \$2,000,000 figure is added back in twice for a total adjustment to the savings of \$4 million. This is significant as it was not clearly indicated in the original law but was clarified by this recent guidance.

Excess compensation amounts

An employee's "excess employee compensation" for any plan year is compensation in excess of \$1 million paid by the plan sponsor during a calendar year in which the plan year begins. The \$1 million amount is indexed for calendar years after 2010, rounded to the next lowest multiple of \$1,000.

For purposes of determining the excess compensation amount, the term "employee" includes:

- Self-employed individuals (compensation includes earned income); and
- Former employees.

The term "plan sponsor" includes all members of the actual plan sponsor's controlled group.

Assets set aside or reserved in a trust or other nonqualified deferred arrangement are treated as compensation and are included in the \$1 million threshold for that year. The amount set aside is equal to the fair market value of assets, determined at the time they are set aside, that are:

- Set aside directly or indirectly in a trust or other arrangement; or
- Transferred to such trust or other arrangement

by a plan sponsor for purposes of paying deferred compensation under a nonqualified deferred compensation plan.

Payments made by a foreign corporation to a foreign trust (or other foreign arrangement) on behalf of a nonresident alien are not considered to be set-aside amounts for the purpose of determining excess compensation provided such payments would not have been subject to U.S. income tax as income effectively connected with the conduct of a trade or business within the United States if they had been paid to the nonresident alien in cash.

The notice also carves out certain exceptions to the definition of excess employee compensation that are disregarded for purposes of determining the \$1 million threshold such as:

- Compensation for services performed before March 1, 2010;
- Restricted stock granted after February 28, 2010, which is subject to a substantial risk of forfeiture for at least five years from the date of the grant;
- Commissions on income generated directly by the employee's performance and the income is a result of a direct sale of a product or service to an unrelated customer in the ordinary course of business of the employer; and
- Nonqualified deferred compensation, restricted stock, stock options or stock appreciation rights that are paid or granted under a binding written contract that was in effect on March 1, 2010, and which was not materially modified.

Excess shareholder payment amounts

PRA 2010 defines “excess shareholder payment amounts” as the total:

- Dividends declared during the plan year by the plan sponsor; plus
- The total amount for redemptions of the plan sponsor’s stock redeemed during the plan year minus the greater of:
 - Plan sponsor’s [adjusted net income](#) for the preceding plan year; or
 - [Historical dividend](#) amount.

Adjusted net income is determined without regard to reductions for interest, taxes, depreciation or amortization. The adjusted net income for the prior plan year is the adjusted net income of the plan sponsor for the fiscal year ending with or during that prior plan year.

Historical dividends are dividends declared in the same manner for at least five preceding plan years. Dividends are deemed to be determined in the same manner for at least five consecutive plan years if the dividends are determined using the same formula (including the same specified dollar amount) or determined on either a per share basis or on an aggregate basis. Examples of dividends determined using the same formula include dividends that:

- Increase by a fixed amount each year;
- Increase by a fixed percentage each year; and
- Are a fixed percentage of income, earnings or other consistently applied measure of profitability.

When determining excess shareholder payments, the following transactions are disregarded:

- Dividends declared and redemptions occurring before March 1, 2010;
- Dividends paid within a controlled group;
- Redemptions made on account of the death, disability or termination of employment of a shareholder or employee; and
- Certain dividends and redemptions with respect to preferred stock issued before March 1, 2010, or which is still held by the plan.

Mergers and acquisitions

PRA 2010 authorized the IRS to issue guidance where there is a merger or acquisition involving a plan sponsor that has elected to use an alternative amortization schedule.

If a plan sponsor that elects to use an alternative amortization schedule merges with, acquires, or is acquired by another company that was not in its controlled group prior to the transaction and that other company either did not sponsor a single-employer plan or did not elect to use an alternative amortization schedule, any aggregate compensation amount for employees of the other company are disregarded for the purpose of determining excess employee compensation. In addition, any dividends or stock redemptions declared by the other company prior to the date of the transaction are disregarded.

However, if the other company involved in the transaction sponsors a plan that elected an alternative amortization schedule, the compensation amounts and shareholder payments for both companies involved in the transaction are combined as if they had been in the same controlled group both before and after the transaction.

Election to use an alternative amortization schedule

A plan sponsor that elects to use an alternative amortization schedule on or after January 1, 2011, must provide written notification of the election to both the:

- Plan’s enrolled actuary; and
- Plan administrator.

The election must be signed and dated by the plan sponsor and must include all of the following information:

- The name of the plan;
- The plan number;
- The name of the plan sponsor;
- The plan sponsor’s mailing address;
- The plan sponsor’s employer identification number;
- Which of the two alternative amortization schedules is being elected;

- The plan year for which the election is being made;
- Whether an alternative amortization schedule has been elected for another year, and, if so, a statement that the same alternative amortization schedule is being elected; and
- A statement that the plan sponsor will notify the PBGC and plan participants and beneficiaries of the plan's election.

The election must be made by the latest of:

- The last day of the plan year for which the election is made;
- 30 days after the valuation date for the plan year for which the election is made; or
- January 31, 2011.

Example: If the valuation date for a plan year is the first day of the plan year, an election for the plan year that begins on January 1, 2011, must be made by December 31, 2011.

A plan sponsor's election may be revoked only with the consent of the IRS, after consultation with the PBGC.

Notification to participants, beneficiaries and PBGC

A plan sponsor that elects funding relief must provide notice of the election ("pension funding relief notice") to participants and beneficiaries by:

- 120 days after the end of the plan year for which an alternative amortization schedule is elected; or
- May 2, 2011, if later.

Example: If an alternative amortization schedule is elected for a plan year beginning June 1, 2010, then the notice must be provided to participants and beneficiaries by September 28, 2011.

If the funding relief election for a plan is made simultaneously for two plan years, notices for both elections can be combined provided the notice identifies both years for which the election is made.

A notice must be provided to all plan participants and beneficiaries. However, a notice does not have to be provided to any person who either became a:

- Plan participant; or
- Beneficiary

after the last day of the plan year ending before the notice is due or ceased to be a participant prior to the date on which the pension funding relief notice is provided.

Content requirements

The pension funding relief notice must provide the following information:

- The name of the plan;
- The plan year for which the funding relief election has been made;
- A general description of the effect of the election, including the fact that the election will delay pension funding and which of the two schedules has been elected; and
- The name, address and telephone number of the plan administrator or other contact person from whom more information may be obtained.

The notice must be written in a manner calculated to be understood by the average plan participant or beneficiary so that the individual will understand the significance of the information provided. Plan sponsors may include any additional information that is necessary or helpful for the recipients to understand the required information, provided the notice does not have the effect of misleading or misinforming or distracting recipients from the required information.

A pension funding notice *must be a separate notice* and cannot be combined with other information. However, a pension funding relief notice can be provided at the same time as another notice is provided. For example, a pension funding relief notice can be provided at the same time the annual funding notice is provided.

The IRS provides [sample language](#) that will satisfy the requirements for the pension funding relief notice. If Prudential Retirement provides actuarial valuation services to your plan, we are prepared to assist plan sponsors in the preparation of the notice.

Notification to PBGC

A plan sponsor must provide the PBGC with a copy of its notice by the later of:

- 30 days after the date of the election; or
- January 31, 2011.

The notification must be e-mailed to the PBGC at single-employer.funding.relief.election@pbgc.gov. The subject of the e-mail must contain the:

- Plan sponsor's employer identification number;
- Plan number; and
- Name of the plan.

Additional information may be required as described in the [transition rules](#).

Delivery requirements

The pension funding relief notice must be in writing and may be furnished in any paper or electronic form to the extent such form is reasonably accessible to participants and beneficiaries. Permissible electronic methods include those permitted by:

- [The Department of Labor \(DOL\)](#); and
- [The final 204\(h\) regulations](#).

Form 5500 requirements

Plan sponsors who elect to use an alternative amortization schedule for a plan year after filing the Form 5500 and Schedule SB for that plan year, which did not reflect this election are not required to file an amended Form 5500. Instead, the Schedule SB filed for a subsequent plan year no later than the 2010 plan year must include an attachment that accurately reflects the effect of any election to use an alternative amortization schedule for the 2008 or 2009 plan year. The IRS provides detailed instructions for reporting the election of an alternative amortization schedule, including the calculations of minimum required contributions for affected plan year(s).

As an alternative, plan sponsors may file an amended Form 5500 with a revised Schedule SB showing the correct information for any previous year.

Transition rules

The IRS guidance discusses the consequences of an election to use an alternative amortization schedule made prior to January 1, 2011, which did not include all the required [information](#). The fact that a plan sponsor did not meet all the requirements does not invalidate the election. It also does not permit the sponsor to revoke the election without receiving approval from the IRS. In addition, the plan sponsor must notify:

- [Participants of the election](#); and
- [The PBGC](#).

The transition rules also discuss the impact of electing an alternative amortization schedule on elections to:

- Increase the prefunding balance; or
- Use the funding standard carryover balance or the prefunding balance (credit balances) to offset the minimum required contribution.

The deadline for making the elections with respect to credit balances must be made no later than the:

- Due date that would otherwise apply for [making the election](#) under IRS regulations; or
- March 31, 2011.

Multiple employer plans

The special funding rules apply separately for each employer under a multiple employer plan, as if each employer maintained a separate plan. As a result, each plan sponsor may independently elect to use an alternative amortization schedule for up to two eligible plan years with respect to the portion of the plan attributable to that sponsor. Other

participating employers in the multiple employer plan may elect to use a different alternative amortization schedule for different eligible plan years, or may decide not to elect to use an alternative amortization schedule.

The notification requirements also apply separately to each participating employer in a multiple employer plan. As a result, the pension funding relief notice must be provided only to those participants and beneficiaries who are associated with a plan sponsor who elects to use an alternative amortization schedule.

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