



For your information

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## IRS finalizes change to anticutback regulation for plans facing distress termination

The IRS finalized a change to its anticutback regulation to provide an exception for an amendment to permanently eliminate lump sums (or other prohibited payment forms) from a defined benefit plan if the plan sponsor is undergoing bankruptcy. Such amendments are now permitted if the plan's AFTAP is less than 100%, the bankruptcy court issues an order saying the amendment is necessary to avoid a distress or involuntary termination, and the PBGC issues a determination that the amendment is necessary to avoid a distress or involuntary termination and that the plan's assets are not sufficient to pay benefits guaranteed by the PBGC termination insurance program ("guaranteed benefits").

### Background

Plans that are subject to the vesting protections in the Internal Revenue Code (Code) and the Employee Retirement Income Security Act (ERISA) generally cannot be amended in a manner that reduces any accrued benefit (including optional forms of payment and certain early retirement and retirement-type benefits). The existing regulation dealing with this "anticutback" rule provides a list of exceptions involving situations in which such amendments are permitted.

In June, the IRS proposed to amend the anticutback regulation to allow a new exception for employers in bankruptcy whose plans cannot make payments in certain optional forms because of the benefit restrictions in Code Section 436. (See our July 2, 2012 [For Your Information](#).) Such an amendment is considered not to eliminate any valuable right of a participant because:

- Participants are barred from receiving lump sums (or other prohibited forms of payment) due to the Section 436 restrictions.
- If the plan is in a distress or involuntary termination, participants cannot receive lump sums because the PBGC generally does not honor lump sum distribution elections in these types of terminations.

## Rule finalized with small tweaks

Under the [final amendment](#) to the anticutback regulation, a plan sponsor in bankruptcy would be permitted to adopt an amendment that eliminates lump sum options (or other protected benefit that is a prohibited payment under the benefit restrictions of Section 436) if all of the following four conditions are met on the later of the date the amendment is adopted or its effective date (“applicable amendment date”):

- The plan’s enrolled actuary certified that the plan’s adjusted funding target attainment percentage (AFTAP) for the plan year that contains the applicable amendment date is less than 100%.
- The plan is not permitted to make any prohibited payment under the benefit restriction rules because the plan sponsor is a debtor in a bankruptcy case (that is, a case under Title 11, United States Code, or under similar federal or state law).
- The court overseeing the bankruptcy case issued an order, after notice to each affected party and a hearing, finding that the adoption of the amendment eliminating that optional form of benefit is necessary to avoid a distress or involuntary termination of the plan before the plan sponsor emerges from bankruptcy (or before the bankruptcy case is otherwise completed).
- The PBGC issued a determination that the plan does not have sufficient funds to cover all guaranteed benefits and that the adoption of the amendment eliminating that optional form of benefit is necessary to avoid a distress or involuntary termination of the plan before the plan sponsor emerges from bankruptcy (or before the bankruptcy case is otherwise completed).

**Buck comment:** The final rule was modified to clarify references about the notice and hearing requirement in the third bullet above to be clear that failure to notify a particular participant or beneficiary does not automatically invalidate the amendment.

## No requirement to add new lifetime options

The IRS’s June proposal asked whether affected plans should be required to offer a term certain and life annuity or 100% joint and survivor annuity option coincident with the elimination of the lump sum so that participants with substandard mortality have the opportunity to protect their survivors. The IRS and Treasury opted not to impose this requirement as a condition for making the amendment.

## Effective date

The final regulation applies to amendments both adopted and effective after November 8, 2012.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.  
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