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Internal Revenue Service Issues Proposed Regulations Regarding Benefit Restrictions for Certain Underfunded Defined Benefit Pension Plans

The Pension Protection Act of 2006 modified the funding requirements for tax-qualified defined benefit pension plans beginning in 2008. It did so by adding a new Code section, Section 436, which sets forth a series of limitations on the accrual and payment of benefits under an underfunded pension plan:

- There is a limitation on plant shutdown and other unpredictable contingent event benefits in situations in which the plan's adjusted funding target attainment percentage ("AFTAP") is less than 60% or would be less than 60% taking into account the occurrence of the event.

- A plan amendment that has the effect of increasing the liabilities of the plan by increasing in benefits (including changes in vesting) may not take effect if the plan's AFTAP for the plan year is less than 80% or would be less than 80% taking into account the amendment.

- If a plan's AFTAP for a plan year is less than 60%, the plan may not make any prohibited payment after the valuation date for the plan year and all future benefit accruals under the plan must cease as of the plan's valuation date. If a plan's AFTAP is at least 60% but less than 80%, the plan may not make any prohibited payment to the extent the payment exceeds the lesser of (1) 50% of the amount otherwise payable under the plan and (2) the present value of the maximum PBGC guarantee with respect to a participant. A "prohibited payment" is any payment in excess of the monthly amount paid under a single life annuity (plus any social security supplements under the plan) to a participant or beneficiary. This rule does not apply if there have been no benefit accruals under the plan beginning September 1, 2005.

The Code also sets forth a series of rules pursuant to which these limitations will not apply to a plan if the employer provides security or make a specified contribution. This specified contribution must be an actual contribution - the employer may not use a prefunding balance or funding standard carryover balance in lieu of making the specified contribution. The specified contribution is also disregarded in determining whether the plan's minimum required contribution has been made.

The proposed IRS regulations provide detailed guidance regarding the implementation of these and related rules with respect to benefit restrictions for underfunded defined benefit plans.

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