Section 412.—Minimum Funding Standards

Additional funding requirements for certain plans. Questions and answers with respect to the establishment and maintenance of amortization bases for certain plans that have additional funding requirements described in section 412(1) of the Internal Revenue Code as amended by the Uruguay Round Agreements Act, which includes the Retirement Protection Act of 1994, are set forth.

Rev. Rul. 96–20

PURPOSE

This revenue ruling provides questions and answers relating to the establishment and maintenance of certain amortization bases under § 412(l) of the Internal Revenue Code, as amended by the Retirement Protection Act of 1994 (RPA '94), which is part of the Uruguay Round Agreements Act, Pub. L. 103–65 (GATT).

BACKGROUND

Section 412 of the Code imposes minimum funding requirements with respect to defined benefit and money purchase pension plans. Section 412(l) sets forth additional funding requirements for certain underfunded defined benefit pension plans that have more than 100 participants and that are not multiemployer plans.

The additional funding charge under § 412(l)(1) is determined as the sum of (1) the excess (if any) of (A) the deficit reduction contribution determined under § 412(l)(2) for the plan year over (B) the sum of certain charges for the plan year under § 412(b)(2) reduced by the sum of certain credits for the plan year under § 412(b)(3), and (2) the unpredictable contingent event amount (if any) for the plan year.

The deficit reduction contribution is determined as the sum of the unfunded new liability amount, the expected increase in current liability due to benefits accruing during the plan year, and the amortization amounts for certain amortization bases. These amortization bases (unfunded old liability, unfunded existing benefit increase liability, additional unfunded old liability, and the liability for unfunded mortality increase) are collectively referred to in this revenue ruling as ''DRC amortization bases.'' The unfunded new liability amount is the applicable percentage of the unfunded new liability. The applicable percentage is based upon the plan's funded current liability percentage. The unfunded new liability is the excess, if any, of the unfunded current liability for the plan year over the sum of (1) the unamortized portions of the DRC amortization bases, and (2) the liability with respect to any unpredictable contingent event benefits for which the unpredictable contingent event has occurred.

The amortization base for the unfunded old liability described in § 412(l)(3)(B) is established, if appropriate, for the plan year beginning in 1989. This unfunded old liability is amortized over 18 years, beginning with the 1989 plan year.

The amortization base for the unfunded existing benefit increase liability described in § 412(l)(3)(C)(ii) is established, if appropriate, for the plan year in which the benefit increase relating to the liability becomes effective, or, at the election of the employer, for the plan year beginning in 1989. This unfunded existing benefit increase liability is amortized over 18 years beginning with the plan year for which the base is established.

RPA '94 amended § 412(l), effective for plan years beginning after December 31, 1994, to further specify the actuarial assumptions used to determine current liability for purposes of § 412(l). Section 412(l)(9)(A), added by RPA '94, provides that § 412(l) does not apply to plans with a funded current liability percentage of at least 90 percent. Section 412(l)(9)(B) provides a volatility rule under which § 412(l) also does not apply (for up to a two-year period) to certain plans with funded current liability percentages of at least 80 percent.

Under RPA '94, the amortization base for the additional unfunded old liability described in § 412(l)(3)(D) is established, if appropriate, for the 1995 plan year. Section 412(l)(3)(E) provides an optional alternative calculation for the additional unfunded old liability. The additional unfunded old liability is amortized over 12 years, beginning with the 1995 plan year.

Under RPA '94, the amortization base for the unfunded mortality increase described in § 412(l)(10)(B) (the increase in current liability resulting from changes in the mortality table used to determine current liability after 1999) is established, if appropriate, in the first plan year a new mortality table issued under § 412(l)(7)(C)(ii)(II) or (III) is used for the plan. This unfunded mortality increase is amortized over a period of 10 years beginning with the plan year in which the base is established.

Any plan year described above for which an amortization base is established, if appropriate, for purposes of § 412(l) is referred to in this revenue ruling as a ''DRC base year.''

QUESTIONS AND ANSWERS ON THE ESTABLISHMENT OF DRC AMORTIZATION BASES

Q-1. If § 412(l) applies to a plan for a plan year that is a DRC base year, must the appropriate DRC amortization base be established for that plan year?

A-1. If § 412(l) applies to a plan for a plan year that is a DRC base year, the appropriate DRC amortization base must be established for that year. Thus, for example, if § 412(l) applies to a plan for the 1995 plan year, the increase in current liability resulting from the required change in actuarial assumptions must be included in the additional unfunded old liability as provided under §§ 412(l)(3)(D) or 412(l)(3)(E) and may not be included in unfunded new liability.

Q-2. If § 412(l) does not apply to a plan for a plan year that is a DRC base year, are any DRC amortization bases established for that year to prepare for the contingency that § 412(l) may apply to the plan in a future plan year?

A-2. If § 412(l) does not apply to a plan for a plan year that is a DRC base year, then except as provided under Q&A-3, no DRC amortization base is established to prepare for the contingency that § 412(l) may apply to the plan in a future plan year. For example, if for the plan year beginning in 1989, a plan had no unfunded current liability, was a multiemployer plan, or had 100 or fewer participants within the meaning of § 412(l)(6), no amortization base for unfunded old liability is established. Similarly, if for the plan year beginning in 1995, a plan had a funded current liability percentage (determined under § 412(l)(9)(C)) of 90 percent or greater, was a multiemployer plan, or had 100 or fewer participants within the meaning of § 412(l)(6), no amortization base for additional unfunded old liability is established.

Q-3. In the case of a plan year that is a DRC base year, if § 412(l) does not apply to a plan for that plan year solely by reason of the application of the exception provided under § 412(l)(9)(B) (taking into account the special rules of § 412(l)(9)(D)), are any DRC amortization bases established for that plan year to prepare for the contingency that § 412(l) may apply to the plan in a future plan year?

A-3. In the case of a plan year that is a DRC base year, if § 412(l) does not apply to a plan for that plan year solely by reason of the application of the exception provided under § 412(l)(9)(B) (taking into account the special rules in § 412(l)(9)(D)), the appropriate DRC amortization base is established for that plan year. Thus, for example, if § 412(l) does not apply to a plan with a funded current liability percentage (determined under § 412(l)(9)(C)) that is at least 80 percent but that is less than 90 percent for the plan year beginning in 1995, solely because of the exception under § 412(l)(9)(B) (taking into account the special rules under § 412(l)(9)(D)), an additional unfunded old liability base is established for that plan year. In such a case, if the optional rule under § 412(l)(3)(E) is to be used to determine the additional unfunded old liability, an employer must make an election which is reported on a timely filed 1995 Form 5500.

Q-4. If § 412(l) does not apply to a plan for a plan year (other than by reason of § 412(l)(9)(B) and (D)) that is a DRC base year (and, thus, no amortization base is established for that plan year in accordance with Q&A-2), is the DRC amortization base that would otherwise have been established if § 412(l) had applied to the plan for that plan year established in any subsequent year?

A-4. If § 412(l) does not apply to a plan for a plan year (other than by reason of § 412(l)(9)(B) and (D)) that is a DRC base year (and, thus, no amortization base is established for that plan year in accordance with Q&A-2), the DRC amortization base that otherwise would have been established if § 412(l) had applied to the plan for that plan year is not established or recreated in any subsequent year. Thus, for example, if a plan's funded current liability percentage (determined under § 412(l)(9)(C)) is at least 90 percent for the 1995 plan year (and, thus, § 412(l) does not apply to the plan for the 1995 plan year), and if § 412(l) applies to the plan for the 1996 plan year, then for the 1996 plan year all of the plan's unfunded current liability will be unfunded new liability (with the possible exception of the liability with respect to any unpredictable contingent event benefits resulting from an unpredictable contingent event that occurs in 1996).

QUESTIONS AND ANSWERS ON THE MAINTENANCE OF DRC AMORTIZATION BASES

Q-5. How is the unamortized portion of a DRC amortization base determined?

A-5. For the plan year for which a DRC amortization base is established, the unamortized portion of that base is the amount of the liability that gives rise to the base, as determined under § 412(l)(3) or (10), as applicable. For any subsequent plan year, the unamortized portion of a DRC amortization base is determined by reducing the unamortized portion as of the valuation date for the prior plan year by the amortization amount for the prior plan year, and adjusting the result with interest to the valuation date in the current plan year at the appropriate current liability interest rate.

Q-6. How is the annual amortization amount for a DRC amortization base determined?

A-6. The annual amortization amount for a DRC amortization base is determined by amortizing the unamortized portion of the DRC amortization base over the remainder of the statutory amortization period using the appropriate current liability interest rate for the plan year. These annual amortization amounts are included in the calculation of the deficit reduction contribution under § 412(l)(2), until the DRC amortization base is fully amortized or considered to be fully amortized.

Q-7. When is a DRC amortization base considered to be fully amortized prior to the end of the scheduled amortization period?

A-7. Except as otherwise provided in this Q&A-7, a DRC amortization base that was established in a prior DRC base year is considered to be fully amortized for the first plan year for which § 412(l) does not apply to the plan. However, if § 412(l) does not apply to the plan for a plan year solely by reason of the exception provided under § 412(l)(9)(B) (taking into account the special rules in § 412(l)(9)(D)), then any DRC amortization bases are not considered to be fully amortized for that plan year, but are maintained in accordance with Q&A-5 above. For example, under the provisions of § 412(l) as in effect prior to amendment by RPA '94, any DRC amortization base is considered to be fully amortized in the first plan year after establishment of such base for which (1) the plan's funded current liability percentage (determined under § 412(l)(8)(B)) is 100 percent or greater, (2) the plan is reestablished as a multiemployer plan, or (3) the plan has 100 or fewer participants within the meaning of § 412(l)(6). Similarly, under the provisions of § 412(l) as in effect after amendment by RPA '94, any DRC amortization base (whether or not created prior to the effective date of RPA '94) is considered to be fully amortized for the first plan year after establishment of such base for which (1) the plan's funded current liability percentage (determined under § 412(l)(9)(C)) is 90 percent or greater, (2) the plan is reestablished as a multiemployer plan, or (3) the plan has 100 or fewer participants within the meaning of § 412(l)(6).

DRAFTING INFORMATION

The principal author of this revenue ruling is Martin L. Pippins of the Employee Plans Division. For further information regarding this revenue ruling, please contact the Employee Plans Division's taxpayer assistance telephone service between 2:30 p.m. and 4:00 p.m. Eastern Time, Monday through Thursday on (202) 622-6076 (Actuarial Hotline) (not a toll-free telephone number). Mr. Pippins' telephone number is (202) 622-6261 (also not a toll-free number).