The Final 430 Regulations: Changes in Funding Rules

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Final 430 Regulation

- On September 9, 2015 Treasury published regulations, primarily on 430 funding issues. The highlights are:
  - Valuations in the year of termination
  - No negative shortfall amortizations
  - A situation in which prefunding balance cannot be used
  - Amortization amounts after change in valuation date
  - Standing elections for use of PFB for missed quarterlies
  - Clarify how five years determined for segment rates
  - Designation of year contribution is for
  - Treatment of prior year missed minimum funding in assets

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Valuation Date in Year of Termination

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Valuation Date in Year of Termination

- The valuation date may not be after the termination date
  - This change is effective only for plan years beginning on or after 1/1/16
  - In operation, this change only impacts plans with end of year valuations
  - The plan termination creates a short plan year
  - The plan termination can create a change in valuation date
  - A required change in valuation date has automatic approval
  - This rule requires a definition of termination date

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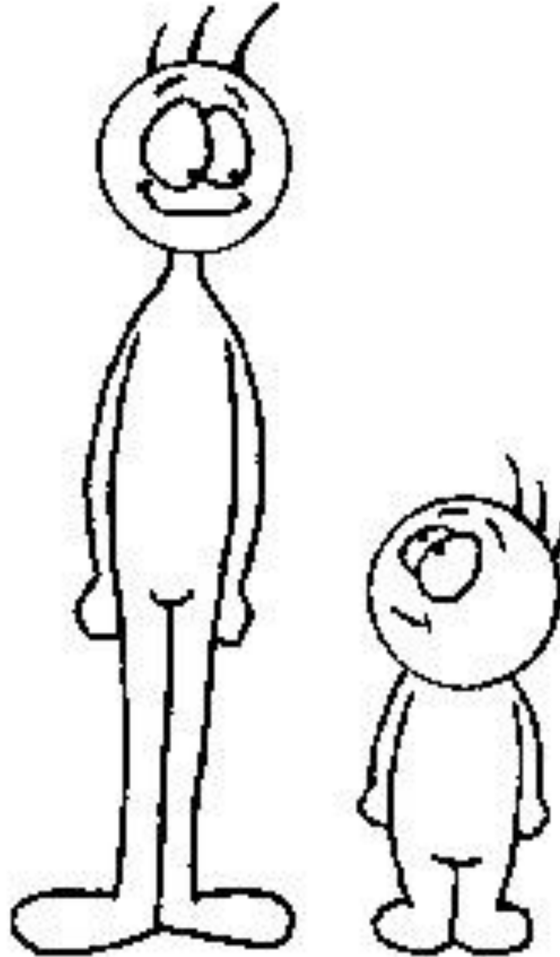
Creates a Short Plan Year



Creates a Short Plan Year

- Under 1.430(a)-1(b)(5) the plan is treated as having a short plan year in the year of termination
- The effect of the short plan year is that the amortization amounts are prorated for the short plan year
- Target normal costs would continue to be the value of the benefit accrued during the plan year
  - If terminated before any benefit accrues, then no target normal cost
  - If terminated after a full years benefit accrual, then full year target normal cost
- Minimum funding is 8½ months after the termination date
- 412(d)(2) election may be an issue

Creates a Change in Valuation Date

- Under 1.430(a)-1(b)(5), if the termination date is before the date that would have otherwise been the valuation date, then the valuation date must be changed to be before the termination date.
- Note that under 1.430(g)-1(b)(2)(i) the valuation date must be during the plan year
- Most common new valuation dates will be the beginning of the plan year or the termination date

Has Automatic Approval

- Assuming that the valuation date must be changed to comply with this rule, under 1.430(g)-1(b)(2)(iv) there is an automatic approval for the change (because any change that is required by 430 receives an automatic approval for the change)

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Requires Definition of Termination Date

- Under 1.430(a)-1(f)(5) two definitions are provided
- One definition is for PBGC-covered plans
- One definition is provided for plans not covered by the PBGC

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Requires Definition of Termination Date

- Under 1.430(a)-1(f)(5)(i), for a plan covered by the PBGC the termination date means the termination date for PBGC purposes
- This would mean that if the PBGC changes the termination date, the valuation date may be wrong (along with other problems)
- How many people have had the PBGC change the termination date?

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Requires Definition of Termination Date

- Under 1.430(a)-1(f)(5)(ii) for a plan not covered by the PBGC, the termination date is the date selected by the plan administrator
- The only requirement appears to be that the termination date cannot precede the date on which all actions (other than the distribution of benefits) necessary to terminate the plan have occurred.
- It would seem that this means, cannot be before latest of:
  - Resolution terminating plan
  - 15 days after 204(h)
  - Actual termination amendment

No Negative Shortfall Amortizations

No Negative Shortfall Amortizations

- The regulation makes clear that if the plan sets up a funding shortfall amortization, which is subsequently followed by a negative funding shortfall amortization, that if the negative amortization from the negative base, when combined with the prior amortization would create a net negative amortization, the amortization amount is artificially set to zero, even though the bases are still maintained.
- Note, the amortization charges still exist, it is just that the minimum required contribution has no amortization charge included

No Negative Shortfall Amortizations

- Regulation 1.430(a)-1(g) example five illustrates this as follows:
  - 1/1/16 funding target $2,500,000
  - 1/1/16 target normal cost $175,000
  - 1/1/16 assets $2,450,000
  - As of 1/1/16, six remaining payments of $60,000 on shortfall base 1
  - As of 1/1/16, five remaining payments of $25,000 on waiver base 2
  - First segment rate 5.26%
  - Second segment rate 5.82%

No Negative Shortfall Amortizations

- The remaining value of base 1 equals
  - $60,000 * present value of five payments at 5.26% plus
  - $60,000 * present value of single payment in five years at 5.82%
  - OR
  - -PV(5.26%,5,60000,0,1) + 60000/1.0582^5
  - 271478.33 + 45218.12
  - 316,696.45 (example in regulation uses 316,696)

No Negative Shortfall Amortizations

- The remaining value of base 2 equals
  - $25,000 * present value of five payments at 5.26%
  - OR
  - -PV(5.26%,5,25000,0,1)
  - 113,115.97 (example in regulation uses 113,116)

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No Negative Shortfall Amortizations

- The new shortfall amortization base equals
  - Funding target of $2,500,000 minus
  - Assets of $2,450,000 for
  - Shortfall of $50,000 minus
  - Value of remaining payments on base 1 of $316,696 minus
  - Value of remaining payments on base 2 of $113,116 for
  - New shortfall amortization base of -379,812

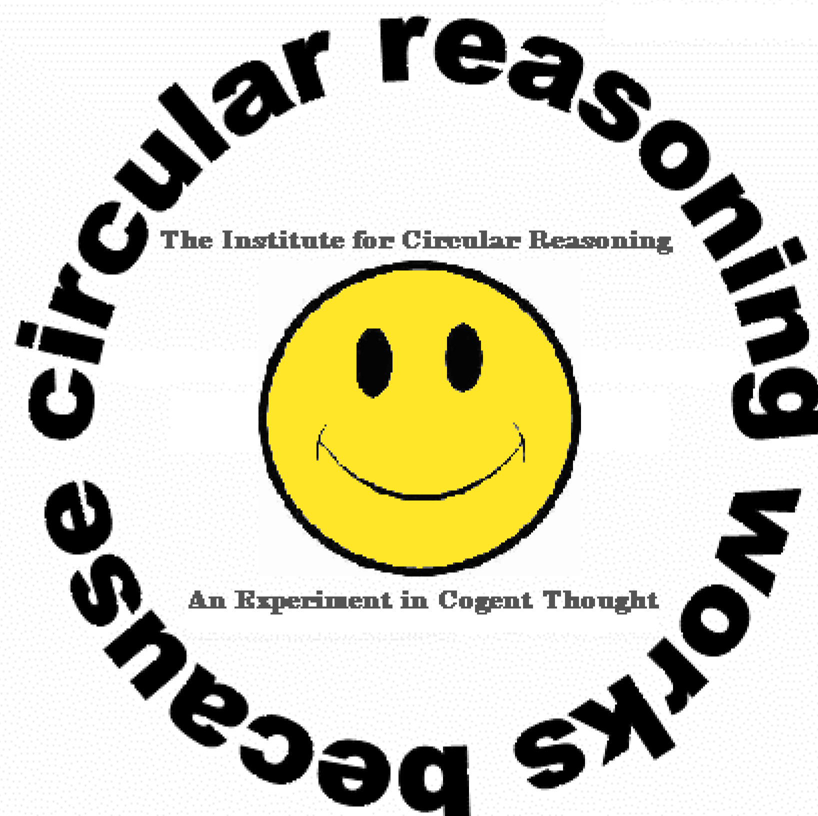
No Negative Shortfall Amortizations

- The amortization of the new base can be determined as:
  - 379,812 / (-PV(5.26%,5,1,0,1)-pv(5.82%,2,1,0,1)/1.0582^5)
  - 379,812 / (4.5246+1.4658)
  - 63,402.81 (example in regulation shows 63,403)
  - How many people would keep the pennies?

No Negative Shortfall Amortizations

- This makes the total shortfall amortization amount:
  - 60,000 plus
  - -63,403
  - Total -3,403
  - Note waiver not combined
  - Since total shortfall amortization is less than zero it is treated as zero (but amortizations continue un-impacted by this rule)

A Situation in Which Prefunding Balance Cannot Be Used



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A Situation in Which Prefunding Balance Cannot Be Used

- Example 9 of regulation 1.430(a)-1(g) shows a situation in which the prefunding balance cannot be used, even though the prior year FTAP exceeded 80%

A Situation in Which Prefunding Balance Cannot Be Used

- In the example, the plan has the following values
  - Funding target 1,100,000
  - Target normal cost 20,000
  - Value of assets 1,150,000
  - Prior shortfall amortization payments of 30,000
  - Value of remaining shortfall amortization payments 150,000
  - Factor for new shortfall amortization 5.9887
  - Funding standard carryover balance 40,000
  - Prefunding balance 60,000
  - Sponsor wants to make minimum contribution

A Situation in Which Prefunding Balance Cannot Be Used

- Ignoring the rule that the assets are not reduced by the prefunding balance for determining if a new base is established when no prefunding balance is used, the plan would not be exempt from establishing a funding shortfall because
  - Funding target 1,100,000 exceeds
  - Value of assets 1,150,000 reduced by
  - Prefunding balance 60,000
  - i.e. 1,100,000 is more than 1,090,000
  - So new base is established

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A Situation in Which Prefunding Balance Cannot Be Used

- The new amortization is:
  - Excess of funding target 1,100,000 over
  - Value of assets 1,150,000 reduced by
  - Funding standard carryover balance 40,000 and
  - Prefunding balance 60,000
  - For funding shortfall of 50,000 reduced by
  - Value of remaining shortfall amortization payments 150,000
  - For new base of -100,000 divided by
  - Factor for new shortfall amortization 5.9887
  - For new amortization amount of -16,698

A Situation in Which Prefunding Balance Cannot Be Used

- This makes the minimum required contribution
  - Target normal cost 20,000 plus
  - Prior shortfall amortization payments of 30,000 plus
  - New shortfall amortization payment of -16,698
  - For minimum required contribution of 33,302

A Situation in Which Prefunding Balance Cannot Be Used

- Now, because
  - 1) The prefunding balance cannot be used until the full funding standard carryover balance has been used, and
  - 2) The funding standard carryover balance of 40,000 exceeds minimum required contribution of 33,302
- No prefunding balance is used to meet the minimum required contribution
- Therefore the special rule that the assets are not reduced by the prefunding balance when determining if a new shortfall amortization is established comes into play

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A Situation in Which Prefunding Balance Cannot Be Used

- Because
  - Funding target 1,100,000 exceeds
  - Value of assets 1,150,000 NOT reduced by
  - Prefunding balance 60,000
  - I.e., 1,100,000 is less than 1,150,000
  - No new base is established

A Situation in Which Prefunding Balance Cannot Be Used

- This makes the minimum required contribution
  - Target normal cost 20,000 plus
  - Prior shortfall amortization payments of 30,000 plus
  - Zero for new amortization amount
  - For minimum required contribution of 50,000

A Situation in Which Prefunding Balance Cannot Be Used

- The plan sponsor may reduce the 50,000 minimum required contribution by the 40,000 funding standard carryover base (but not by the prefunding balance), so
- The plan sponsor must contribute 10,000

A Situation in Which Prefunding Balance Cannot Be Used

- Example ten points out that the plan sponsor could simply elect to reduce the funding standard carryover base by 9,000 and that would resolve the problem (because then the funding standard carryover base would be insufficient to cover the minimum required contribution, and the prefunding balance would be used, causing the new base to be established)
- Example ten fails to note the timing issues (i.e., that the election would have to be made before the end of the plan year)

A Situation in Which Prefunding Balance Cannot Be Used

- How many people are wondering why someone stayed up at night to think up this example?

Amortization Amounts After Change in Valuation Date

Amortization Amounts After Change in Valuation Date

- Regulation 1.430(a)-1(c) makes clear that the amortization amount is not changed due to a change in the valuation date
- This is illustrated in example 12 of 1.430(a)-1(g)

Amortization Amounts After Change in Valuation Date

- In the example:
  - The plan year is a calendar year
  - In 2015 the plan has 97 participants
  - In 2016 the valuation date is July 1
  - On July 1, 2016 an amortization base is established with a payment of 50,359
  - During 2016 the number of participants exceeds 100

Amortization Amounts After Change in Valuation Date

- For the 2017 plan year
  - Because there were more than 100 participants during 2016, the valuation date is changed to January 1, 2017
  - The amortization payment due on January 1, 2017 for the base established in 2016 remains at 50,358 (despite that fact that logically it should be adjusted with interest)
  - How many people have a calendar year plan with a July 1 valuation date?

Standing Elections for Use of PFB for Missed Quarterlies

- Regulation 1.430(f)-1(f)(1)(iii) allows for a standing election to use the funding standard carryover balance and prefunding balance to satisfy quarterly contributions
- Like other elections, election must be in writing and cannot take effect prior to being provided to the plan's enrolled actuary
- The reduction in the balance is deemed to occur on the later of date provided to the plan's enrolled actuary or the due date of the quarterly contribution
- The timing could impact availability of the balance for other purposes

Clarify How Five Years Determined for Segment Rates

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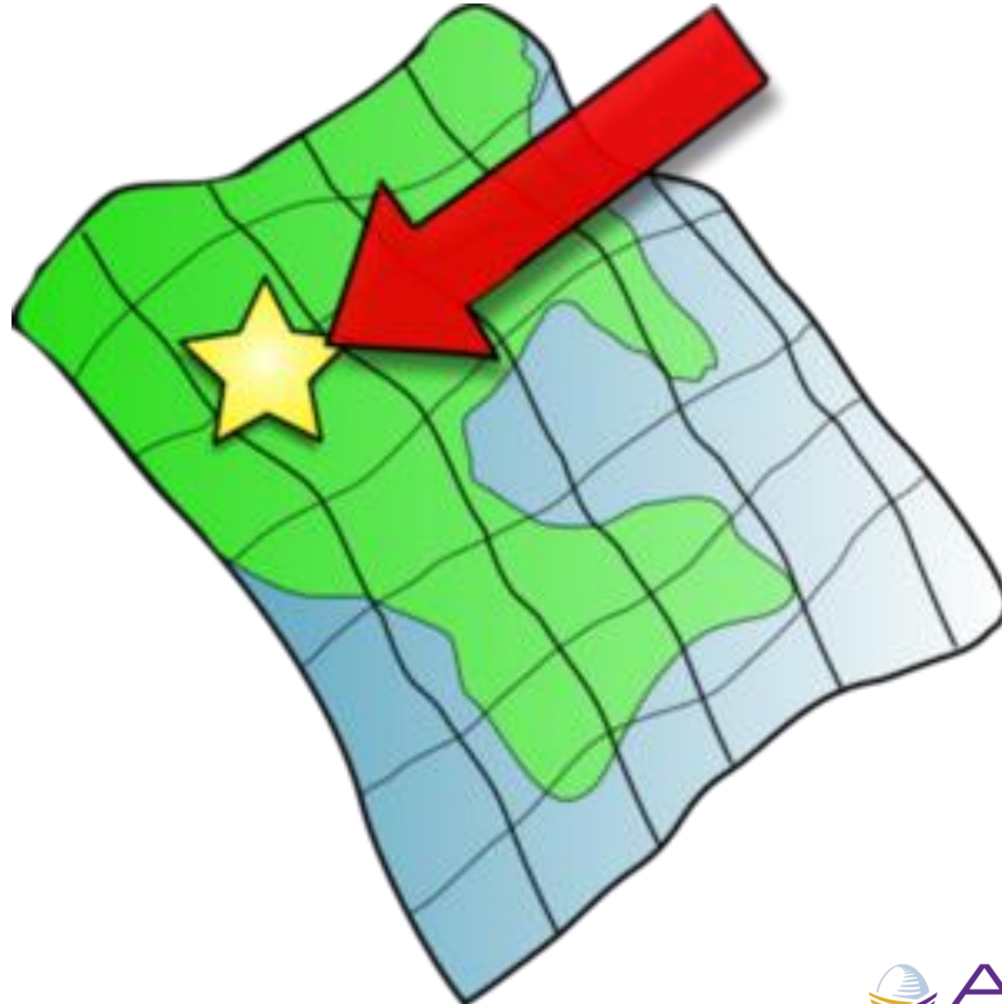
Clarify How Five Years Determined for Segment Rates

- The regulation clarifies (consistent with changes made as part of HATFA) that the five-year period during which the first segment rate applies is measured, not from the beginning of the plan year, but from the valuation date
- How many people were not already applying the rule this way, prior to the regulation?

Designation of Year Contribution Is For



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Designation of Year Contribution Is For

- Regulation 1.430(j)-1(b)(3) as amended makes clear:
  - While there is an ordering rule on contribution that requires that no contribution can be made for a later year until the minimum funding for a prior year has been satisfied, once the minimum funding for the prior year has been satisfied, the contributions can be designated for either the prior or current year (for contributions made after the end of the prior year but before 8½ months after the end of the prior year).
  - The reporting of the contribution on the Schedule SB is the designation (and once made, cannot be changed).

Ordering Rule on Contribution

- The interesting issue here is how this rule would work in operation
- Consider a plan with a minimum required contribution for 2015 of 100,000 (and no prefunding balances)
- The plan sponsor makes no contributions during 2015
- The plan sponsor makes three contributions during 2016
  - 110,000 on March 1, 2016
  - 50,000 on April 1, 2016
  - 40,000 on June 1, 2016

Ordering Rule on Contribution

- At least 100,000 of the March 1, 2016 contribution must be designated for 2015 (ignoring interest issues)
- The remaining portion of the March 1, 2016 contribution could be designated for either 2015 or 2016
- The full 50,000 contribution made on April 1, 2016 could be designated for either 2015 or 2016 (or split between the two)
- Even if the full 50,000 contribution made on April 1, 2016 is designated for 2016, the full contribution of 40,000 on June 1, 2016 (or any portion of it) could be designated for 2015

Ordering Rule on Contribution

- In other words, once the minimum funding for 2015 is satisfied, any contribution made between January 1, 2016 and September 15, 2016 can be designated for either 2015 or 2016 as seen fit.

The Reporting of the Contribution on the Schedule SB Is the Designation

- The implications of this rule are:
  - The designation of the year for deduction purposes is unrelated to the designation of the year for minimum funding purposes
  - If an error is made on a Schedule SB it can cause various problems
  - It raises the issue of who decides which year a contribution is designated for (and potentially how)

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The Year for Deduction Purposes Is Unrelated to the Year for Minimum Funding Purposes

- The lack of a rule requiring coordination between minimum funding and maximum deduction would seem to clearly imply no coordination is required
- The IRS informally has stated that designation for 404 and 412 were required to be coordinated
- More to the point, if the reporting on the Schedule SB is out of sync with when the contribution was deducted, there may be no means to correct, further implying this is not a problem
- How many people would have thought this was the rule prior to this regulation being issued?

If an Error Is Made on a Schedule SB it Can Cause Various Problems

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If an Error Is Made on a Schedule SB it Can Cause Various Problems

- Consider three types of errors, and how they interact with this rule
  - A contribution was made, but not reported
  - A contribution was reported as made, but was not (maybe a typo on the form)
  - A contribution was incorrectly reported for the wrong year

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A Contribution Was Made, But Not Reported

- On the one hand, the regulation says that an election "cannot be changed after the actuarial report that reflects the contribution is completed (and filed, if required) except as provided in guidance published in the Internal Revenue Bulletin."
- Of course no guidance exists yet for changing an election, but an absence of an election is not an election, so arguably if the contribution was not reported, it was not "reflect"ed and therefore amending the SB to reflect the contribution is not a change

A Contribution Was Made, But Not Reported

- On the other hand, by not reporting the contribution, a default election to not designate the contribution for the year has been made (and cannot be changed)
- On the other hand, if a contribution is made in May 2017, and is not reported on either the 2016 or 2017 SB, then, when the contribution is discovered in 2018, clearly it must be reported on either the 2016 or 2017 SB

A Contribution Was Reported as Made, But Was Not

- It would seem logically that no designation could be made for a contribution that was not made, so correcting the SB is not changing the designation

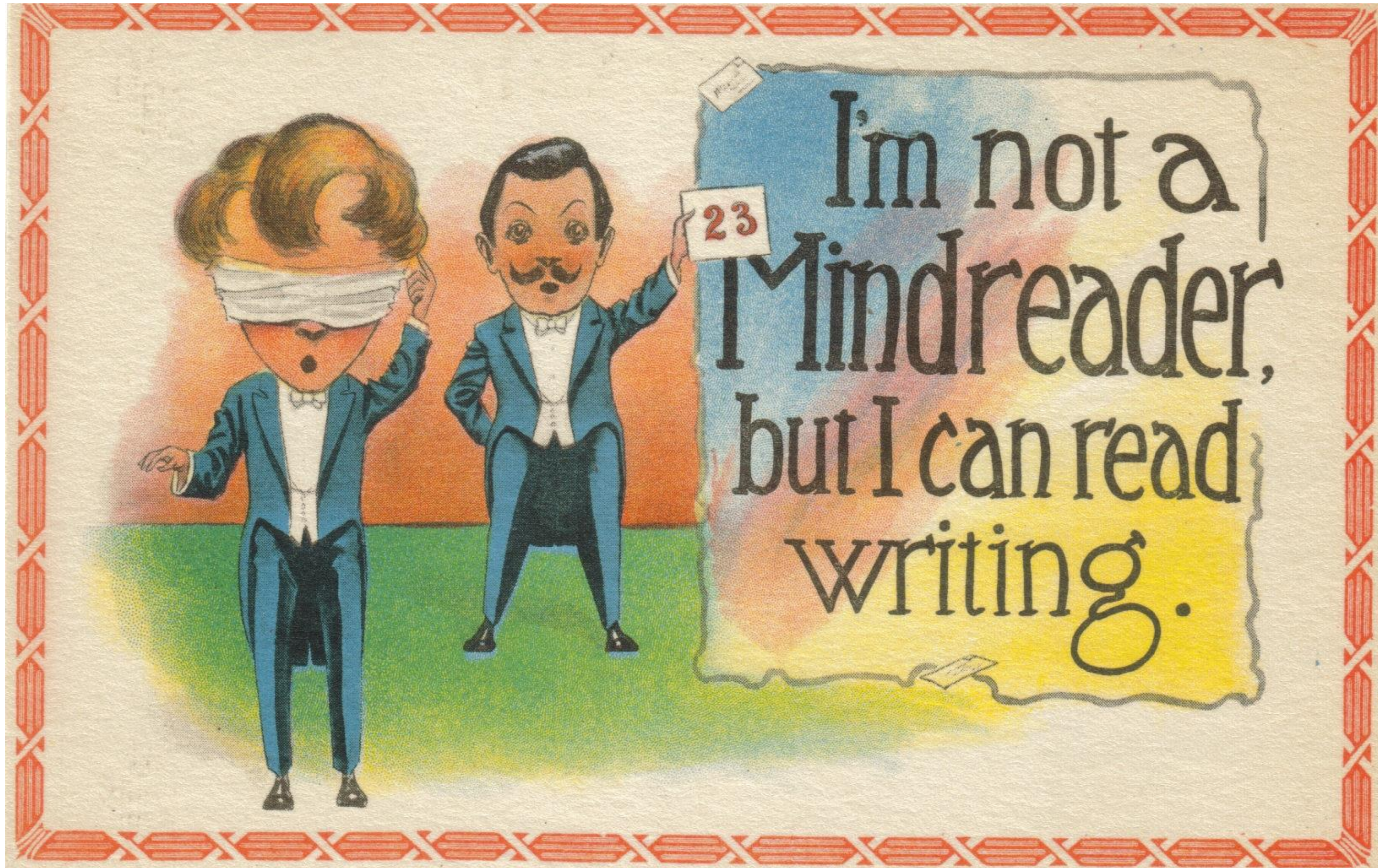
A Contribution Was Incorrectly Reported for the Wrong Year

- This appears to be what is targeted by this rule, and this cannot be changed
- For example, the plan sponsor makes a contribution in May 2017 (after the minimum funding has already been satisfied)
- The contribution is reported on the 2016 SB filed in June 2017
- In August 2017 the plan sponsor decides that they want to designate the contribution from 2017, not 2016
- In this case, it is too late, the SB cannot be changed to designate the contribution as being for the 2017 plan year

Who Decides for Which Year a Contribution Is Designated?

- Since the enrolled actuary completes the SB, this means that, by default, in the eyes of the IRS, the enrolled actuary makes the final decision as to which year a contribution is designated for
- This may open the actuary to issues if the enrolled actuary exercise discretion over the designation, particularly if it impacts whether an AFTAP is above or below 60% or 80%
- To be on the safe side, the enrolled actuary should require the plan sponsor to tell the enrolled actuary which plan year each contribution is intended to be for

Who Decides for Which Year a Contribution Is Designated?



Treatment of Prior Year Missed Minimum Funding in Assets

- Example three of regulation 54.4971(c)-1(g) states
- (iii) The funding shortfall as of January 1, 2008 is calculated as the difference between the funding target and the value of assets as of that date. The assets are not adjusted by the amount of the accumulated funding deficiency. The fact that the contribution was not made for the 2007 plan year means that the January 1, 2008 funding shortfall is larger than it would have been otherwise.

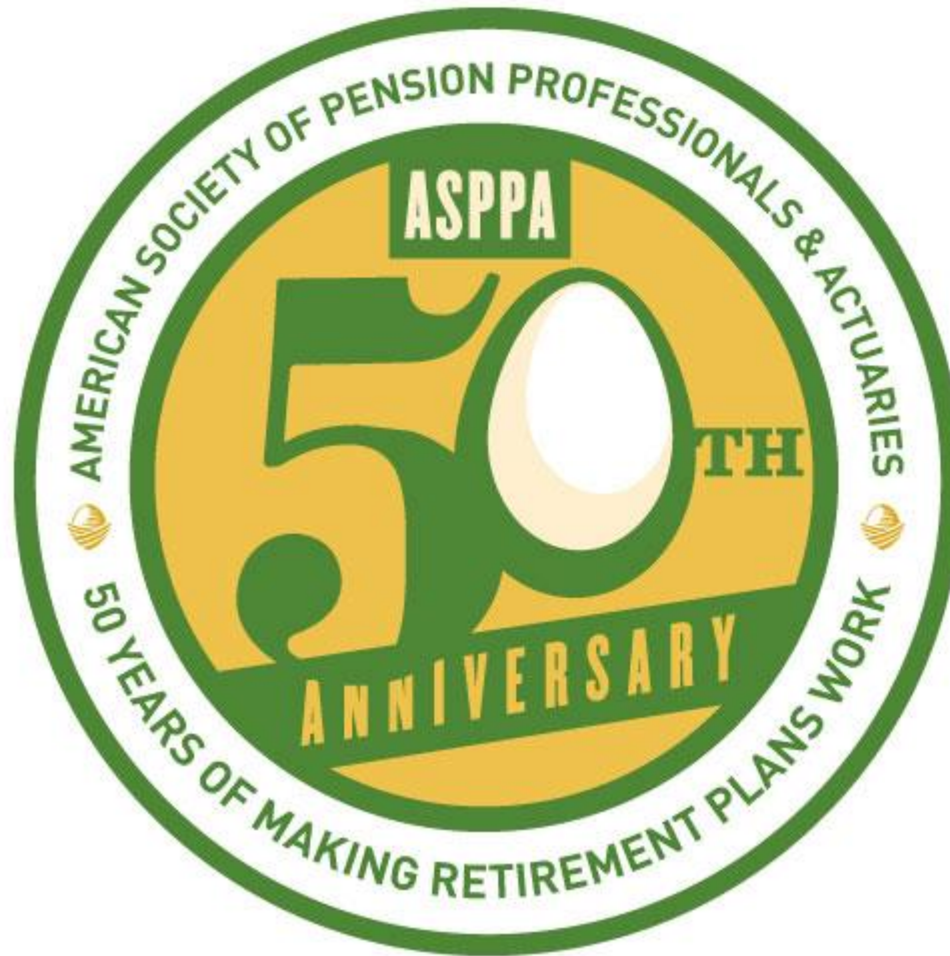
Treatment of Prior Year Missed Minimum Funding in Assets

- It would seem clear that "as of that date" would include contributions made after the end of the prior plan year, but before the minimum funding deadline, even though the regulations fail to address that issue
- It would also seem clear that the drafter of the regulation realizes that this means that the missed minimum funding will ultimately be funded in part through the funding shortfall amortization and in full when the prior year minimum funding is funded, but they didn't care.

Treatment of Prior Year Missed Minimum Funding in Assets

- So consider a plan that has a $100,000 funding deficiency on 1/1/2016 (which is not timely funded)
- This means that there is an additional $100,000 funding shortfall, leading to an additional $100,000 funding shortfall base, leading to an (approximate) $18,000 additional minimum required contribution
- If in December 2016, the plan sponsor decides to correct the funding shortfall, they will owe the $100,000 (plus interest) in addition to the additional $18,000 of minimum required contribution for 2016

Questions?



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