



SUMMARY

IRS/Treasury Release Final 415 Regulations

On April 4, the Internal Revenue Service (IRS) and the U.S. Treasury Department (Treasury) released final regulations under Internal Revenue Code (Code) Section 415 which contains limitations on benefits and contributions under qualified retirement plans. Comprehensive Code Section 415 regulations were last issued in 1981 and the final regulations incorporate much of the interim guidance, usually provided in the form of IRS Notices, issued since 1981. The final regulations closely follow the proposed regulations released in May 2005 with some modifications, including additions made due to the changes to Code Section 415 made in the Pension Protection Act of 2006 (PPA).

The Council filed a comment letter on the proposed regulations and testified in the Code Section 415 regulatory hearing. The final regulations address a number of the issues raised by the Council.

The final regulations are effective April 5, 2007, but apply to limitation years beginning on or after July 1, 2007. Generally, the regulatory changes will be applied starting January 1, 2008 to plans with a calendar year limitation year (most plans). The regulations do permit some changes to be applied earlier.

Some of the significant changes or modifications from the proposed regulations include:

- Automatic Increases. For forms of benefit not subject to the requirements of Code Section 417(e)(3), no actuarial adjustments need to be made to reflect automatic increases if certain requirements are satisfied (otherwise the annual benefit must reflect the value of the automatic increases). Generally, the plan must provide that the amount payable in any limitation year cannot be greater than the Code Section 415(b) limit applicable at the annuity starting date, as increased in subsequent years pursuant to Code Section 415(d).
- High-3 Active Participation Requirement. For purposes of determining the high-3 average compensation, the proposed regulations would have required that compensation be earned while an active plan participant. The Pension Protection Act of 2006 eliminated the active participation requirement for years beginning

after December 31, 2005. This change is noted in the preamble to the regulation but is not incorporated in the final regulations.

- High-3 and Compensation Limit. The final regulations continue to require that compensation in each of the three years cannot exceed the annual compensation limit under Code Section 401(a)(17). However, the final regulations include a grandfather provision that allows compensation in excess of the 401(a)(17) limit to be counted for benefits accrued or payable under the plan as of the end of the limitation year that is immediately prior to the effective date of the regulations if relevant plan provisions (including the plan's limitation year) were both adopted and in effect before April 5, 2007.
- Post-Termination Pay. The final regulations, like the proposed regulations, generally provide that amounts received following severance from employment are not considered compensation for purposes of Code Section 415. The final regulations modify one exception made in the proposed regulations and create a couple of new exceptions. The time frame for the exception for payments under bona fide sick, vacation or other leave, etc. that would have been available for use if employment had not been terminated has been expanded to the later of 2-1/2 months after the severance from employment or the end of the limitation year that includes the date of severance from employment (the proposed rule was limited to 2-1/2 months). The final regulations also permit a plan to allow post-severance payment from a nonqualified deferred compensation plan to be included if a taxable payment is made within the timeframe described above and the payment would have been made at the same time if the employee had continued his or her employment. Another exception was created for post-severance compensation paid to a permanently and totally disabled participant, provided certain conditions are satisfied.
- Multiple Annuity Starting Dates. The preamble notes that numerous comments were made and Treasury and the IRS need to make revisions to these rules and that they are developing new proposed regulations (the final regulations reserve a place for these). However, the final regulations do address cost-of-living adjustments, including the proposed regulatory safe harbor allowing plan provisions that incorporate by reference the annual Code Section 415(d) cost-of-living adjustments (treated as continuing to satisfy Code Section 415(b) without becoming subject to the multiple annuity starting date rules). The final rule also includes two new safe harbors to cover situations where benefits are increased periodically by plan amendments to reflect the Code Section 415(d) cost-of-living adjustments.
- Restorative Payments. The proposed regulations provided that annual additions (which are subject to the 415 limit) do not include payments made to restore losses to a plan resulting from action by a fiduciary for which there is a

reasonable risk of liability for breach of fiduciary duty under Title I of ERISA. The final regulations expand that to include fiduciary actions (or a failure to act) that creates a reasonable risk of liability for breach of fiduciary duty under ERISA and other applicable federal or state law.

- Amounts Includible under Code Section 409A. The final regulations clarify that 415 compensation includes amounts that are includible in the income of an employee under the rules of Code Section 409A for nonqualified deferred compensation.
- Employer Aggregation Rules. The final rule makes several changes to employer aggregation rules including the aggregation rules that apply to Code Section 403(b) annuity contracts, other plans of the employer, and plans of related employers.