

Part I

Section 401.—Qualified Pension, Profit-sharing, and Stock Bonus Plans (Also, §§ 411, 415; 26 CFR 1.401(a)(31), 1.411(a)-4, 1.411(a)-4T, 1.411(c)-1, 1.415(b)-1.)

Rollover from qualified defined contribution plan to qualified defined benefit plan to obtain additional annuity

Rev. Rul. 2012-4

ISSUES

- (1) Does a qualified defined benefit pension plan that accepts a direct rollover of an eligible rollover distribution from a qualified defined contribution plan maintained by the same employer satisfy §§ 411 and 415 of the Internal Revenue Code in a case in which the defined benefit plan provides an annuity resulting from the direct rollover that is determined by converting the amount directly rolled over into an actuarially equivalent immediate annuity using the applicable interest rate and the applicable mortality table under § 417(e)?
- (2) How does the result vary if the defined benefit plan applies different conversion factors for purposes of calculating the annuity resulting from the amount directly rolled over?

FACTS

Plan A is a profit-sharing plan sponsored by Employer X that is qualified under § 401(a). Plan A satisfies the requirements under § 401(a)(11)(B)(iii) to be exempted from the qualified joint and survivor annuity and qualified preretirement survivor annuity rules of § 401(a)(11). Plan A does not provide for after-tax employee contributions.

Plan B is a qualified defined benefit plan also sponsored by Employer X. Plan B permits benefits to commence at any time after separation from service and offers various optional forms of benefit. Plan B complies with all otherwise applicable rules under § 401(a), including the rules of §§ 401(a)(11), 411(a)(11), and 417 with respect to distributions and does not apply the rule of § 411(a)(11)(D) (i.e., does not disregard rollover contributions for purposes of mandatory distributions of small amounts). As permitted under § 411(a)(3)(A), Plan B provides that, except to the extent of the qualified preretirement survivor

annuity, the accrued benefit resulting from employer contributions is forfeited on the death of the participant. Plan B provides that a participant can elect to commence a distribution between 30 days and 180 days after the furnishing of the QJSA explanation that is required pursuant to § 417(a)(3). Plan B does not permit participants to elect a retroactive annuity starting date as provided under § 417(a)(7).

Plan B provides that it will accept a direct rollover from Plan A for any employee or former employee of Employer X who separates from service after age 55 with at least 10 years of service. Plan B will accept direct rollovers from Plan A with respect to an employee or former employee only if the individual is electing or has elected to commence receiving benefits from Plan B and the election specifies a single annuity starting date for all of the employee's or former employee's benefits under Plan B (including the additional benefit resulting from the direct rollover, which is determined as described below).

Neither Plan A nor Plan B is a governmental plan, a nonelecting church plan, or another plan to which § 411 does not apply under § 411(e)(1). Plan B does not contain a qualified cost-of-living arrangement within the meaning of § 415(k)(2).

Participant P's employment with Employer X terminates, and Participant P elects a distribution from Participant P's Plan A account balance that is made in the form of a direct rollover to Plan B. Participant P elects to receive payment of the benefit attributable to the rollover in the form of an annuity from Plan B. For the entire plan year that includes the date of the rollover, Plan B's adjusted funding target attainment percentage under § 436(j)(2) is at least 60 percent. Participant P is over age 55 and has at least 10 years of service with Employer X.

Plan B provides that if a participant in both Plan A and Plan B elects a direct rollover from Plan A to Plan B and elects to use that direct rollover amount to obtain an immediate straight life or other form of annuity from Plan B, then the amount of that annuity is determined as the actuarial equivalent of the amount rolled over from Plan A, where actuarial equivalence is determined using the applicable interest rate and mortality table under § 417(e). A package of election forms is used for the distribution from Plan A, the election of a direct rollover to Plan B, and the election of an immediate annuity from Plan B. The package provides for notarized spousal consent if the participant is married and elects a distribution from Plan B that is not a qualified joint and survivor annuity, and is accompanied by a disclosure that includes a statement that if Plan B terminates with insufficient funds to cover its benefit liabilities, the benefit resulting from the direct rollover will be subject to Title IV of the Employee Retirement Income Security Act of 1974 (ERISA), Public Law 93-406, and a description of the

maximum benefit limitation and other relevant Title IV limitations on guaranteed benefits.¹

Plan B provides that if a participant in both Plan A and Plan B elects a direct rollover from Plan A to Plan B but the annuity starting date is after the time of the direct rollover (which could occur under Plan B if the annuity starting date elected by a participant is not more than 180 days after the date of the election notice provided under Plan B), then the amount of the annuity is determined by crediting the amount directly rolled over with interest at 120 percent of the Federal mid-term rate under § 1274 until the annuity starting date and then converting the resulting amount to an actuarially equivalent immediate annuity using the applicable interest rate and the applicable mortality table under § 417(e) that apply at that later annuity starting date.

If a participant under Plan B dies before the annuity starting date, a benefit equal to any amount directly rolled over by the participant to Plan B from Plan A (plus interest as described above) will be paid from Plan B to the participant's beneficiary, which is in addition to the death benefit under Plan B that would be paid if no amount had been directly rolled over to Plan B. However, if such a participant is married at the time of death and the participant did not waive (with notarized spousal consent) the qualified preretirement survivor annuity payable in accordance with §§ 401(a)(11) and 417, then the death benefit instead is a life annuity to the surviving spouse that is actuarially equivalent to the amount directly rolled over to Plan B from Plan A (plus interest as described above) determined using the applicable interest rate and mortality table under § 417(e), which is also in addition to the death benefit under Plan B that would be paid if no amount had been directly rolled over to Plan B.

LAW

Section 401(a)(7) requires that a qualified plan satisfy the requirements of § 411. Section 401(a)(16) requires that a qualified plan not provide for benefits or contributions that exceed the limitations of § 415.

Section 401(a)(31) requires that a participant in a qualified plan be permitted to elect to have a distribution made in the form of a direct rollover to another eligible retirement plan if the distribution qualifies as an eligible rollover distribution. Section 1.401(a)(31)-1, A-15, of the Income Tax Regulations provides that, for purposes of applying the plan qualification requirements of § 401(a), a direct rollover is a distribution and rollover of the eligible rollover distribution (rather

¹ The Pension Benefit Guaranty Corporation (PBGC) has informed the Service that Title IV generally applies to benefits resulting from a rollover, and is developing guidance on the Title IV treatment of such benefits, including guarantee limitations under section 4022 of ERISA and asset allocation under section 4044(a) of ERISA.

than a transfer of assets and liabilities). Section 1.401(a)(31)-1, A-13, provides that a qualified plan is not required to accept rollovers or it can provide that it will accept rollovers under limited circumstances.

Section 411(a)(1) requires that the accrued benefit derived from an employee's contributions be nonforfeitable. Section 1.411(a)-4T provides that adjustments in benefits, such as adjustments in excess of reasonable actuarial assumptions, can result in an impermissible forfeiture of participants' rights. Section 1.411(a)-4(b)(1)(ii) provides that the benefit derived from employee contributions is not treated as forfeitable merely because, after commencement of annuity payments, the participant dies without receiving payments equal in amount to the nonforfeitable accrued benefit derived from mandatory contributions determined at the time of commencement.

Section 411(c)(2) prescribes rules for the determination of the accrued benefit derived from employee contributions. Under § 411(c)(2)(B), in the case of a qualified defined benefit plan, the accrued benefit derived from the contributions made by an employee is equal to the accumulated contributions expressed as an annual benefit commencing at normal retirement age, using an interest rate which would be used under the plan under § 417(e)(3) (as of the determination date). Section 411(c)(2)(C) defines accumulated contributions as the mandatory contributions made by the employee, increased by interest. With respect to periods during plan years beginning on or after January 1, 1988, the interest is determined using the rate of 120 percent of the Federal mid-term rate under § 1274 for the first month of each plan year for the period ending on the date the determination is being made, and using the interest rate under § 417(e)(3) for the period between the determination date and the normal retirement age. Under § 411(c)(2)(C) and § 1.411(c)-1(c)(4), mandatory contributions are defined as amounts contributed to the plan by the employee which are required as a condition of employment, as a condition of participation in the plan, or as a condition of obtaining benefits (or additional benefits) under the plan attributable to employer contributions.

Section 411(c)(3) requires that, if the accrued benefit derived from employee contributions is to be determined with respect to a benefit other than an annual benefit in the form of a single life annuity (without ancillary benefits) commencing at normal retirement age, the accrued benefit derived from contributions made by the employee must be the actuarial equivalent of the amount determined under § 411(c)(2).

Section 415(a)(1)(A) provides that, in the case of a qualified defined benefit plan, the associated trust will not be a qualified trust if the plan provides benefits with respect to a participant in excess of the limitations under § 415(b). Section 415(b)(1) prescribes limitations that are based on the annual benefit determined under § 415(b)(2). Section 415(b)(2)(B) provides for adjustments, in accordance

with regulations, to the benefit determined under the plan if employees contribute or make rollover contributions to the plan.

Section 1.415(b)-1(b)(1) prescribes rules for the determination of the annual benefit for purposes of § 415(b). Under § 1.415(b)-1(b)(1)(ii), the annual benefit does not include the annual benefit attributable to rollover contributions as described in § 401(a)(31). Section 1.415(b)-1(b)(2) provides rules for the determination of the annual benefit attributable to rollover contributions. Under § 1.415(b)-1(b)(2)(iii), the annual benefit attributable to rollover contributions is determined by applying the factors applicable to mandatory employee contributions as described in § 411(c)(2)(B) and (C) and the regulations thereunder.

Section 401(a)(29) requires that a qualified defined benefit plan (other than a multiemployer plan) satisfy the requirements of § 436. Section 436 sets forth a series of limitations on the accrual and payment of benefits under an underfunded plan. Section 436(b) places limitations on the payment of plant shutdown benefits and other unpredictable contingent event benefits; § 436(c) places limitations on plan amendments that increase liabilities for benefits; § 436(d) places limitations on the payment of accelerated benefit distributions; and § 436(e) places limitations on benefit accruals. These limitations are applied based on the plan's adjusted funding target attainment percentage (AFTAP) for the plan year, as certified by the plan's enrolled actuary.

ANALYSIS

Under § 1.401(a)(31)-1, A-15, an amount directly rolled over from Plan A to Plan B is treated as if it were distributed to Participant P from Plan A and then rolled over into Plan B. Accordingly, this amount is treated as contributed by Participant P to Plan B. Furthermore, the contribution is required as a condition of receiving additional benefits under Plan B attributable to employer contributions. For example, if the employee lives longer than the life expectancy under the mortality table used to calculate the annuity and there are no offsetting actuarial gains or the plan earns less than the interest rate used to calculate the annuity, the employer would be required to make contributions to provide the additional benefits. Thus, under § 1.411(c)-1(c)(4), the amounts directly rolled over are treated as mandatory contributions for purposes of § 411(c) and the accrued benefit derived from those amounts, determined under the rules of § 411(c), must be nonforfeitable.

The benefit resulting from the direct rollover that Plan B provides as an immediate annuity is determined as the actuarial equivalent of the amount rolled over from Plan A, where actuarial equivalence is determined using the applicable interest rate and mortality table under § 417(e). Furthermore, in the event of a delay between the rollover and the annuity starting date, interest on the rollover contribution is accumulated in accordance with the requirements of

§ 411(c)(2)(C)(iii). Thus, Plan B satisfies the requirements of § 411(c)(2) with respect to the rollover.

Prior to the annuity starting date under Plan B, the benefit resulting from the amount directly rolled over is not forfeitable, even if the participant were to die prior to the annuity starting date. If the participant were to die after the annuity starting date, the benefit resulting from the amount directly rolled over is not treated as being forfeited as a result of the cessation of the annuity, even if the participant dies prior to having received an amount equal to the amount rolled over to Plan B from Plan A plus interest as described above.

Accordingly, Plan B's provisions relating to the benefit resulting from the amount directly rolled over satisfy the requirement of § 411(a)(1) that the benefit derived from an employee's own contributions be nonforfeitable. In addition, the Plan B benefit resulting from the amount directly rolled over is excluded from Participant P's annual benefit for purposes of § 415(b). This is because, under § 1.415(b)-1(b), the annual benefit for purposes of § 415(b) excludes the benefit attributable to rollover contributions, determined using the rules of § 411(c)(2)(B) and (C), and the Plan B benefit resulting from the amount directly rolled over is determined using the rules of § 411(c)(2)(B) and (C).

However, if Plan B were to use a less favorable actuarial basis (such as an interest rate that is lower than the applicable interest rate under § 417(e)(3)(C) or a mortality table with longer life expectancies than the applicable mortality table under § 417(e)(3)(B)) to determine the amount of an annuity resulting from the amount rolled over, Plan B would not satisfy the requirement under § 411(a)(1) that the benefit derived from an employee's own contributions be nonforfeitable.

By contrast, if Plan B were to use a more favorable actuarial basis (such as a higher interest rate than the § 417(e)(3)(C) applicable interest rate or a mortality table with shorter life expectancies than the applicable § 417(e)(3)(B) mortality table) for purposes of calculating the annuity resulting from the rollover amount, or otherwise provided for a larger annuity than the annuity derived from employee contributions as determined under § 411(c), then the portion of the Plan B benefit resulting from the amount directly rolled over that exceeds the benefit derived from that rolled over amount under the rules of § 411(c)(2)(B) is not treated as the benefit derived from the employee's own contributions and there are other considerations which must be taken into account. For example, the liability for additional benefits under Plan B will likely be greater than the assets transferred to the Plan (which means that the employer will become responsible for additional funding costs). Similarly, the excess portion would be included in the annual benefit for purposes of § 415(b). In addition, any benefit that exceeds the actuarial equivalent of the amount directly rolled over (determined using reasonable actuarial assumptions) would not be treated as attributable to the rollover within the meaning of § 1.401(a)(4)-11(b)(1), and,

accordingly, would be taken into account in applying the nondiscriminatory amount requirement of § 1.401(a)(4)-1(b)(2).

The election procedures under Plans A and B that are described in the facts of this revenue ruling satisfy the requirements of §§ 401(a)(11), 411(a)(11), and 417.

If Plan B's certified or presumed AFTAP were to drop below 60%, Plan B would not be permitted to receive direct rollover contributions from Plan A because such rollover contributions would give rise to additional benefit accruals that are not permitted under § 436(e).

The analysis in this revenue ruling would be the same if Plan B allowed the annuity resulting from the amount directly rolled over to have an annuity starting date that differs from the annuity starting date for the remainder of the Plan B benefits.

HOLDINGS

- (1) Under the facts presented, a qualified defined benefit plan that accepts a direct rollover of an employee's or former employee's benefit from a qualified defined contribution plan maintained by the same employer does not violate § 411 or 415 if the defined benefit plan provides an annuity resulting from the direct rollover that is determined by converting the amount directly rolled over into an actuarially equivalent immediate annuity using the applicable interest rate and applicable mortality table under § 417(e).
- (2) If a defined benefit plan were to provide an annuity resulting from the rollover amount that is determined using a less favorable actuarial basis than required under the rules of § 411(c) (so that the annuity is smaller than required under the rules of § 411(c)), then the plan would not satisfy the requirements of § 411(a)(1).
- (3) If a defined benefit plan were to provide an annuity resulting from the rollover amount that is determined using a more favorable actuarial basis than required under the rules of § 411(c) (so that the annuity is larger than required under the rules of § 411(c)), then the portion of the benefit resulting from the amount directly rolled over that exceeds the benefit derived from that rolled over amount under the rules of § 411(c)(2)(B) would be subject to the non-forfeiture rules applicable to benefits derived from employer contributions and would be included in the annual benefit for purposes of § 415(b).

PROSPECTIVE APPLICATION

Pursuant to the authority provided by § 7805(b)(8), the holdings of this revenue ruling do not apply with respect to rollovers made before January 1, 2013. However, plan sponsors are permitted to rely on the holdings of this ruling with respect to rollovers made prior to that date.

DRAFTING INFORMATION

The principal author of this revenue ruling is Carolyn E. Zimmerman of the Employee Plans, Tax Exempt and Government Entities Division. Ms. Zimmerman may be reached by e-mail at RetirementPlanQuestions@irs.gov.