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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9601]

RIN 1545-BK94

Amendment of Prohibited Payment Option under Single-Employer Defined Benefit Plan of Plan Sponsor in Bankruptcy

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance under the anti-cutback rules of section 411(d)(6) of the Internal Revenue Code, which generally prohibit plan amendments eliminating or reducing accrued benefits, early retirement benefits, retirement-type subsidies, and optional forms of benefit under qualified retirement plans. These regulations provide an additional limited exception to the anti-cutback rules to permit a plan sponsor that is a debtor in a bankruptcy proceeding to amend its single-employer defined benefit plan to eliminate a single-sum distribution option (or other optional form of benefit providing for accelerated payments) under the plan if certain specified conditions are satisfied. These regulations affect administrators, employers, participants, and beneficiaries of such a plan.

DATES: Effective date: These regulations are effective on **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

Applicability date: These regulations apply to plan amendments that are adopted and effective after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE**

**FEDERAL REGISTER]**.

FOR FURTHER INFORMATION CONTACT: Neil S. Sandhu or Linda S.F. Marshall at (202) 622-6090.

SUPPLEMENTARY INFORMATION:

**Background**

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 411(d)(6) of the Internal Revenue Code (Code). These final regulations amend §1.411(d)-4 of the Treasury regulations.

Section 401(a)(7) provides that a trust does not constitute a qualified trust unless its related plan satisfies the requirements of section 411 (relating to minimum vesting standards). Section 411(d)(6)(A) provides that a plan is treated as not satisfying the requirements of section 411 if the accrued benefit of a participant is decreased by an amendment of the plan, other than an amendment described in section 412(d)(2) of the Code or section 4281 of the Employee Retirement Income Security Act of 1974, Public Law 93-406 (88 Stat. 829 (1974)), as amended (ERISA).

Section 411(d)(6)(B) provides that a plan amendment that has the effect of eliminating or reducing an early retirement benefit or a retirement-type subsidy, or eliminating an optional form of benefit, with respect to benefits attributable to service before the amendment is treated as impermissibly reducing accrued benefits. For a retirement-type subsidy, this protection applies only with respect to a participant who satisfies (either before or after the amendment) the preamendment conditions for the subsidy. The last sentence of section 411(d)(6)(B) provides that the Secretary may by regulations provide that section 411(d)(6)(B) does not apply to a plan amendment that eliminates an optional form of benefit (other than a plan amendment that has the effect of eliminating or reducing an early retirement benefit or a retirement-type subsidy).

Section 436(d)(2) provides that a defined benefit plan which is a single-employer plan must provide that, during any period in which the plan sponsor is a debtor in a case under title 11, United States Code, or similar Federal or State law (a "bankruptcy case"), the plan may not pay any "prohibited payment." However, that limitation does not apply in a plan year on or after the date on which the enrolled actuary of the plan certifies that the adjusted funding target attainment percentage (as defined in section 436(j)(2)) of the plan for the plan year is not less than 100 percent.

Section 436(d)(5) sets forth a definition of the term prohibited payment. Under this definition, a "prohibited payment" is: (1) any payment in excess of the monthly amount paid under a single life annuity (plus any social security supplements described in the last sentence of section 411(a)(9)) to a participant or beneficiary whose annuity starting date (as defined in section 417(f)(2)) occurs during any period a limitation under section 436(d)(1) or section 436(d)(2) is in effect; (2) any payment for the purchase of an irrevocable commitment from an insurer to pay benefits; and (3) any other payment specified by the Secretary by regulations. The term "prohibited payment" does not include the payment of a benefit which under section 411(a)(11) may be immediately distributed without the consent of the participant.

Section 1.411(d)-4, Q&A-1(a) provides that the term section 411(d)(6) protected benefit includes: (1) benefits described in section 411(d)(6)(A); (2) early retirement benefits (as defined in §1.411(d)-3(g)(6)(i)) and retirement type subsidies (as defined in §1.411(d)-3(g)(6)(iv)); and (3) optional forms of benefit described in section

411(d)(6)(B)(ii).

Section 1.411(d)-4, Q&A-1(b)(1) provides that the term optional form of benefit for purposes of §1.411(d)-4 has the same meaning as in §1.411(d)-3(g)(6)(ii). Section 1.411(d)-3(g)(6)(ii)(A) defines the term "optional form of benefit" as "a distribution alternative (including the normal form of benefit) that is available under the plan with respect to an accrued benefit or a distribution alternative with respect to a retirement-type benefit. Different optional forms of benefit exist if a distribution alternative is not payable on substantially the same terms as another distribution alternative. The relevant terms include all terms affecting the value of the optional form, such as the method of benefit calculation and the actuarial factors or assumptions used to determine the amount distributed. Thus, for example, different optional forms of benefit may result from differences in terms relating to the payment schedule, timing, commencement, medium of distribution (for example, in cash or in kind), election rights, differences in eligibility requirements, or the portion of the benefit to which the distribution alternative applies."

Section 1.411(d)-4, Q&A-2(a)(1) provides that a plan is not permitted to be amended to eliminate or reduce a section 411(d)(6) protected benefit that has already accrued, except as provided in §1.411(d)-3 or §1.411(d)-4. Under §1.411(d)-4, Q&A-2(b)(1), the Commissioner is authorized to provide for the elimination or reduction of an optional form of benefit to the extent that plan participants do not lose either a valuable right or an employer-subsidized optional form of benefit when a similar optional form of benefit with a comparable subsidy is not provided.[1] In addition, §1.411(d)-4, Q&A-

[1] Such an amendment can be authorized only through the publication of revenue rulings, notices, and other documents of general applicability. See §601.601(d)(2)(ii)(b).

2(b)(2)(i) through (xi) sets forth specific situations under which the elimination or reduction of certain section 411(d)(6) protected benefits that have already accrued does not violate section 411(d)(6). These exceptions have been included in regulations pursuant to the IRS's authority under the last sentence of section 411(d)(6)(B) to permit a plan amendment that eliminates or reduces optional forms of benefit (other than a plan amendment that has the effect of eliminating or reducing an early retirement benefit or a retirement-type subsidy).

Section 1.436-1(d)(2) provides that a plan satisfies the requirements of section 436(d)(2) and §1.436-1(d)(2) only if the plan provides that a participant or beneficiary is not permitted to elect an optional form of benefit that includes a prohibited payment, and the plan will not pay any prohibited payment, with an annuity starting date that occurs during any period in which the plan sponsor is a debtor in a case under title 11, United States Code, or similar Federal or State law, except for payments made with an annuity starting date that occurs on or after the date within the plan year on which the enrolled actuary of the plan certifies that the plan's adjusted funding target attainment percentage for the plan year is not less than 100 percent.

Title IV of ERISA provides for a pension plan termination insurance program that is administered by the Pension Benefit Guaranty Corporation (PBGC). PBGC guarantees nonforfeitable benefits, up to specified limits, for defined benefit pension plans that are covered under the program.[2] If a single-employer plan terminates in a distress termination under section 4041(c) of ERISA or an involuntary termination under section 4042 of ERISA, and the plan assets are not sufficient to provide all guaranteed benefits, PBGC pays benefits to participants and beneficiaries under the provisions of

[2] See section 4021 of ERISA.

Title IV and PBGC's regulations.[3] PBGC allows a participant who is not in pay status at the time of the termination to elect among the various annuity forms described in 29 C.F.R. 4022.8. In addition, under 29 C.F.R. 4022.7, PBGC does not pay benefits in a single sum in excess of $5,000 (except under certain limited circumstances).

Section 204(g) of ERISA contains rules that are parallel to Code section 411(d)(6). Under section 101 of Reorganization Plan No. 4 of 1978 (43 FR 47713) and section 204(g) of ERISA, the Secretary of the Treasury has interpretive jurisdiction over the subject matter addressed in these regulations for purposes of ERISA, as well as the Code. Thus, these regulations issued under section 411(d)(6) of the Code apply as well for purposes of section 204(g) of ERISA.

On June 21, 2012, the IRS issued proposed regulations under section 411(d)(6) (77 FR 37349) to provide an additional limited exception to the anti-cutback rules to permit a plan sponsor that is a debtor in a bankruptcy proceeding to amend its single-employer defined benefit plan to eliminate a single-sum distribution option (or other optional form of benefit providing for accelerated payments) under the plan if certain conditions are satisfied. Several comments were received on the proposed regulations. No public hearing was requested or held. After consideration of the comments received, the IRS and the Treasury Department are issuing these final regulations to adopt the rules set forth in the proposed regulations with minor modifications.

**Explanation of Provisions**

These final regulations provide a limited exception under section 411(d)(6)(B) to permit a plan sponsor that is a debtor in a bankruptcy proceeding to amend its single-employer defined benefit plan to eliminate a single-sum distribution option (or other

[3] See section 4022 of ERISA.

optional form of benefit providing for accelerated payments) if certain conditions are satisfied.

In particular, the regulations permit a single-employer plan that is covered under section 4021 of ERISA to be amended, effective for a plan amendment that is both adopted and effective after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**, to eliminate an optional form of benefit that includes a prohibited payment described in section 436(d)(5), provided that four conditions are satisfied on the later of the date the amendment is adopted or effective (the applicable amendment date, as defined in §1.411(d)-3(g)(4)). First, the enrolled actuary of the plan has certified that the plan's adjusted funding target attainment percentage (as defined in section 436(j)(2)) for the plan year that contains the applicable amendment date is less than 100 percent. Second, the plan is not permitted to pay any prohibited payment, due to application of the requirements of section 436(d)(2) of the Code and section 206(g)(3)(B) of ERISA, because the plan sponsor is a debtor in a bankruptcy case (that is, a case under title 11, United States Code, or under similar Federal or State law). Third, the court overseeing the bankruptcy case has issued an order, after notice to the affected parties and a hearing,[4] finding that the adoption of the amendment eliminating that optional form of benefit is necessary to avoid a distress termination of the plan pursuant to section 4041(c) of ERISA or an involuntary termination of the plan pursuant to section 4042 of ERISA before the plan sponsor emerges from bankruptcy (or before the bankruptcy case is otherwise completed). Fourth, PBGC has issued a determination that the adoption of the amendment eliminating that optional form of benefit is necessary to avoid a distress or involuntary termination of the plan before the

[4] See 11 U.S.C. § 102(1).

plan sponsor emerges from bankruptcy (or before the bankruptcy case is otherwise completed) and that the plan is not sufficient for guaranteed benefits within the meaning of section 4041(d)(2) of ERISA.

These regulations exercise the Secretary's authority under the last sentence of section 411(d)(6)(B) in order to permit this type of amendment that eliminates an optional form of benefit in these limited circumstances. The legislative history of section 411(d)(6)(B), which was added by section 301(a) of the Retirement Equity Act of 1984, Public Law 98-397, states the intent that Treasury regulations could permit the elimination of an optional form of benefit if "(1) the elimination of the option does not eliminate a valuable right of a participant or beneficiary, and (2) the option is not subsidized or a similar benefit with a comparable subsidy is provided."[5] The legislative history further states that the committee "expects that the regulations will not permit the elimination of a 'lump-sum distribution option' because, for a participant or beneficiary with substandard mortality, the elimination of that option could eliminate a valuable right even if a benefit of equal actuarial value (based on standard mortality) is available under the plan."[6]

If the four conditions set forth in the regulations are satisfied, a single-sum distribution option or other optional form of benefit that includes a prohibited payment (generally a payment that is in excess of the monthly amounts payable under a single life annuity) would not currently be available and would not be available in the future. The plan would not currently be permitted to pay that optional form of benefit because section 436(d)(2) (which imposes restrictions on the payment of prohibited payments

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[5] S. Rep. No. 98-575, at 30 (1984).
[6] Id.

while the plan sponsor is in bankruptcy) bars the payment of such an optional form of benefit under these conditions. Furthermore, the bankruptcy court and the PBGC would each have issued a determination that the plan would be terminated in a distress or involuntary termination unless that optional form of benefit were eliminated. In addition, the PBGC would have determined that the plan is not sufficient for guaranteed benefits. In such a case, pursuant to §4022.7 and §4022.8 of the PBGC regulations, the optional form of benefit would not have been available after the plan termination. Accordingly, the elimination of the optional form of benefit would not result in the loss of a valuable right of a participant or beneficiary.

In addition, the plan amendment would not eliminate or reduce early retirement benefits or retirement-type subsidies, which would continue to be available under the plan. Because the plan would not be terminated in a distress or involuntary termination, participants would continue to be credited with additional service under the plan and could become eligible for early retirement benefits and retirement-type subsidies, regardless of whether participants received benefit accruals with respect to the additional service. Moreover, because the plan would not be terminated, the plan might have the opportunity to recover from its underfunded status.

Under these final regulations, a judicial determination must be made, after notice to the plan participants and beneficiaries, each employee organization representing plan participants, and the PBGC, and a hearing, that the amendment is necessary to avoid termination of the plan in a distress or involuntary termination before the plan sponsor emerges from bankruptcy (or before the bankruptcy case is otherwise completed). The primary purpose of this notice and hearing requirement is to afford plan participants who may be affected the opportunity to be heard on whether the amendment is necessary to avoid plan termination.  The proposed regulations required notice to each affected party, within the meaning of section 4001(a)(21) of ERISA, and a hearing.  At the suggestion of a commenter, the language with respect to this notice and hearing requirement has been modified slightly from the proposed regulations to clarify that a failure to notify a particular participant or beneficiary does not automatically invalidate the amendment.  Specifically, the change clarifies that the standard in 11 U.S.C. § 102(1) applies for purposes of determining whether adequate notice has been provided under the requirement in the final regulations that there be a notice and a hearing before the order is issued by the Bankruptcy Court.  The final regulations require that notice be provided to the affected parties, as defined in section 4001(a)(21) of ERISA.

The preamble to the proposed regulations requests comments on whether the regulations should impose additional conditions on the prospective elimination of the single-sum distribution option (or other optional form of benefit that includes a prohibited payment), such as a condition that, after the amendment, the plan must offer annuity distribution options that provide substantial survivor benefits, such as both (1) a life annuity with a term certain of 15 or more years and (2) a 100% joint and survivor annuity, in order to give participants who have substandard mortality the opportunity to protect their survivors.  Two commenters indicated support for these additional conditions, and one commenter questioned their value to participants.  After consideration of the comments received on this issue, the IRS and the Treasury Department have determined not to impose this requirement as a condition of making a plan amendment permitted under these regulations.

If a plan sponsor eliminates a single-sum distribution option (or other optional form of benefit that includes a prohibited payment) pursuant to these regulations under a plan that does not offer other optional forms of benefit that provide substantial survivor benefits, then, in order to continue to provide participants who have substandard mortality the opportunity to protect their survivors, the plan sponsor can add other optional forms of benefit that provide substantial survivor benefits (including other optional forms of benefit that are prohibited payments under section 436(d)(5)) as part of the same amendment that eliminates the single-sum distribution option (or other optional form of benefit that includes a prohibited payment). All provisions of such a plan amendment (including both the elimination of the single-sum distribution option and the addition of optional forms of benefit that provide substantial survivor benefits) would be considered together for purposes of determining whether the plan amendment would be permitted to take effect in accordance with the rules of section 436(c).

**Effective/Applicability Dates**

These regulations apply to plan amendments that are adopted and effective after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**. This date is modified from the proposed regulations to avoid a retroactive effective date.

**Special Analyses**

It has been determined that these regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these final regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

**Drafting Information**

The principal authors of these regulations are Neil S. Sandhu and Linda S.F. Marshall, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in the development of these regulations.

**List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.411(d)-4 is amended by adding a new paragraph A-2(b)(2)(xii) to read as follows:

<u>§1.411(d)-4 Section 411(d)(6) protected benefits</u>.

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A-2: * * *

(b) * * *

(2) * * *

(xii) Prohibited payment option under single-employer defined benefit plan of plan sponsor in bankruptcy. A single-employer plan that is covered under section 4021 of the Employee Retirement Income Security Act of 1974, Public Law 93-406 (88 Stat. 829 (1974)), as amended (ERISA), may be amended, effective for a plan amendment that is both adopted and effective after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**, to eliminate an optional form of benefit that includes a prohibited payment described in section 436(d)(5), provided that the following conditions are satisfied on the applicable amendment date (as defined in §1.411(d)-3(g)(4)):

(A) The enrolled actuary of the plan has certified that the plan's adjusted funding target attainment percentage (as defined in section 436(j)(2)) for the plan year that contains the applicable amendment date is less than 100 percent.

(B) The plan is not permitted to pay any prohibited payment, due to application of the requirements of section 436(d)(2) of the Internal Revenue Code and section 206(g)(3)(B) of ERISA, because the plan sponsor is a debtor in a bankruptcy case (that is, a case under title 11, United States Code, or under similar Federal or State law).

(C) The court overseeing the bankruptcy case has issued an order, after notice to the affected parties (as defined in section 4001(a)(21) of ERISA) and a hearing, within the meaning of 11 U.S.C. 102(1), finding that the adoption of the amendment eliminating that optional form of benefit is necessary to avoid a distress termination of the plan pursuant to section 4041(c) of ERISA or an involuntary termination of the plan pursuant to section 4042 of ERISA before the plan sponsor emerges from bankruptcy (or before the bankruptcy case is otherwise completed).

(D) The Pension Benefit Guaranty Corporation has issued a determination that--

(1) The adoption of the amendment eliminating that optional form of benefit is necessary to avoid a distress or involuntary termination of the plan before the plan sponsor emerges from bankruptcy (or before the bankruptcy case is otherwise completed); and

(2) The plan is not sufficient for guaranteed benefits within the meaning of section 4041(d)(2) of ERISA.

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Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

Approved: November 2, 2012.

Mark J. Mazur,
Assistant Secretary of the Treasury (Tax Policy).

**[FR Doc. 2012-27336 Filed 11/07/2012 at 8:45 am; Publication Date: 11/08/2012]**