

IRS Issues Guidance for Money Purchase Pension Plans

The IRS recently issued Revenue Procedure 98-42. This revenue procedure offers guidance to sponsors of money purchase pension plans on the repeal of the family aggregation rules that applied when determining plan contributions based on compensation subject to the annual compensation limit (now, \$160,000). It discusses how the repeal of the family aggregation rules affects minimum funding standards, plan funding and deductible employer contributions.

The Small Business Job Protection Act of 1996 (SBJPA) repealed the compensation limit family aggregation rules. The repeal of these rules means that plan sponsors now have the ability to make contributions on behalf of each family member as an individual participant.

Operational Compliance Rules

Generally, plan sponsors do not have to amend their plans to reflect SBJPA changes until the last day of the 1999 plan year. However, until the plans are actually amended, plan sponsors must administer them in accordance with any changes that are effective before the amendment deadline (this is referred to as "operational compliance"). Unfortunately, money purchase pension plan sponsors that have complied with the operational compliance rules and have been operating their plans since 1997 using the new compensation limit rules may have unintentionally violated minimum funding rules and made contributions exceeding the deductible contribution limit.

Minimum Funding and Deductible Contribution Rules

Under the minimum funding rules, the plan sponsor must contribute to a money purchase pension plan an amount equal to the total amount of contributions determined for all plan participants under the plan's contribution formula. Only plan amendments that have been adopted by the employer's tax filing deadline can be taken into account when determining this required contribution. This is where operational compliance with the SBJPA compensation limit rules may cause problems.

Many plan documents describe in detail the old compensation limit rules, including the family aggregation requirement. Although this aggregation is no longer required, it is still permitted. Therefore, under a strict interpretation of the minimum funding rules, money purchase plans should be administered by continuing to apply the old family aggregation rules until those provisions are removed by actual plan amendments. In many cases, this is not how plans have been administered.

*Republished December 2004 to reflect Prudential Financial's acquisition of CIGNA's retirement business.

In addition, the deductible contribution limit for a money purchase pension plan is generally the minimum funding required contribution. By determining contributions without regard to plan-provided family aggregation rules, plan sponsors would also have made contributions that exceed the deductible contribution limit. Nondeductible contributions are subject to a 10% excise tax.

IRS Provides Relief

Recognizing that many plan sponsors did not realize the technical problems created by the operational compliance rules, the IRS is now providing relief. To take advantage of this relief and avoid plan funding problems and nondeductible contributions, a plan sponsor must:

- Make contributions to the plan within 8½ months after the close of the applicable plan year (1997 or 1998);
- Allocate the contributions to participants' accounts within the applicable plan year; and
- Adopt the plan amendment eliminating the family aggregation provisions by the SBJPA amendment deadline.

Plan sponsors do not have to take any action at this point, but do have to be sure to adopt their SBJPA plan amendments by the amendment deadline.

IRS Revenue Procedure 98-42 Example

Employer O maintains a money purchase pension plan with a calendar plan year. This plan benefits three employees: Robert, Phyllis and John. Robert and Phyllis are husband and wife and are each highly compensated. John is not related to either Robert or Phyllis. The plan provides that the employer will contribute annually 10% of each employee's compensation for the plan year, with compensation limited to the annual compensation limit. The plan also contains the family aggregation rules, as in effect prior to their repeal by SBJPA. Therefore, the amount that may be contributed on behalf of Robert and Phyllis may not, in total, exceed 10% of the annual compensation limit.

Robert and Phyllis each receive \$90,000 of compensation for the 1997 plan year. John receives \$70,000. The annual compensation limit for the 1997 plan year is \$160,000. As a result, taking the plan's family aggregation rules into account, the required deductible contribution for 1997 would be \$23,000 (that is, \$16,000 or 10% of \$160,000 which is the contribution for Robert and Phyllis, plus \$7,000 for John.)

However, Employer O expects to amend the plan by the SBJPA amendment deadline to eliminate the plan's family aggregation provisions effective as of the first day of the 1997 plan year. Employer O therefore disregards the plan's family aggregation provisions and contributes \$25,000 for the 1997 plan year on August 15, 1998. This amount is allocated as of December 31, 1997, as follows: \$9,000 each for Robert and Phyllis and \$7,000 for John. Employer O amends the plan by December 31, 1999 to eliminate the family aggregation provisions, effective as of the first day of the 1997 plan year.

As a result, the plan amendment is deemed to have been adopted and put into effect as of the first day of the 1997 plan year for purposes of applying the funding and deductibility rules.

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