

Funding-Based Benefit Limits for Single Employer Plans (IRC section 436) – Full Version

- Requirements of IRC section 436 apply only to single employer or multiple employer plans (not multiemployer plans) and are needed to satisfy the plan qualification requirement of IRC section 401(a)(29).
- The rules for multiple employer plans are applied as if each employer maintained its own plan.
- The requirements of IRC section 436 do not apply to plans in existence for less than 5 years (including years of a predecessor plan), other than the limitations on accelerated benefit distributions. For this purpose, a predecessor plan is any other defined benefit plan maintained by the employer (or predecessor employer) within the past 5 years that includes any participants from the current defined benefit plan.
- The basic purpose of IRC section 436 is to limit increases in plan liabilities or large distributions that may drain the plan's assets when the plan is under-funded.
- A terminating plan subject to the limitations of IRC section 436 prior to termination will continue to be subject to the restrictions after the plan termination date. However, any restrictions on distributions under IRC section 436(d) will not apply with regard to distributions made in conjunction with the plan termination as allowed by law. (For example, a plan can purchase annuities from an insurance company with regard to the standard termination of a plan regardless of whether the restrictions on distribution rules otherwise apply.)

- The *adjusted funding target attainment percentage* (AFTAP) for purposes of IRC section 436 is determined in a similar manner to the funding target attainment percentage (FTAP) under IRC section 430. Recall that the FTAP under IRC section 430 is equal to the ratio of the actuarial assets (reduced by the funding standard carryover and prefunding balances) to the funding target (without regard to at-risk assumptions). For purposes of the AFTAP, the actuarial assets are adjusted by adding the total amount of annuity purchases for NHCEs made during the past 2 years. A participant is deemed to be an NHCE if they are not an HCE at the time of the annuity purchase. The same addition that was made to the actuarial assets with regard to purchases of annuities is also made to the funding target.
 - Receivable contributions for the prior year cannot be included in the value of the assets if they were contributed after the date that the AFTAP is being certified.
 - The AFTAP is determined on the valuation date. Note for exam – there are currently no regulations for determination of the AFTAP in an end of year valuation, so all exam questions will involve first day valuations at this point.
 - The AFTAP is deemed to be 100% if the denominator of the AFTAP is 0.

- AFTAP for fully funded plans
 - If the ratio of the actuarial assets (determined without reduction for the carryover and prefunding balances) to the funding target (determined without regard to the at-risk assumptions) is at least 100% (92% for 2008, 94% for 2009, and 96% for 2010), then the AFTAP is based upon the assets unreduced by the carryover and prefunding balance. Note that the 94% threshold for 2009 and 96% threshold for 2010 can only be substituted for the 100% if the AFTAP for each of the prior years (2008 and 2009) was determined without reducing the actuarial assets by the carryover and prefunding balances because of the application of the 92% and 94% transition percentages.
- Security provided by the plan sponsor can be treated as an asset for purposes of determining the AFTAP.
 - The form of security can be:
 - A surety bond,
 - Cash (or US obligations with no more than a 3-year maturity date) held in escrow, or
 - Other forms under IRS regulations (current regulations do not provide for any other forms of security).
 - The security can be required to be used upon the earliest of:
 - The date of plan termination,
 - The minimum funding due date upon failure to meet minimum funding, or
 - The valuation date in the 7th year if the AFTAP for 7 consecutive years is less than 60%.
 - The security can be released under IRS regulations.

- Certification of AFTAP by enrolled actuary
 - IRC section 436 *measurement date* is the date which stops or starts the restrictions under IRC section 436.
 - An enrolled actuary must certify the AFTAP, and the date of certification becomes the measurement date provided it occurs during the first 9 months of the plan year.
 - The certification must be in writing and be provided to the plan administrator.
 - The certification must include the value of the plan assets, the prefunding balance, the funding standard carryover balance, the funding target, the amount of annuity purchases used to adjust the assets and funding target, UCE benefits that were taken into account, and plan amendments that were taken into account.
 - The actuarial assumptions and cost method must be the same as was used for the determination of the minimum required contribution for the year.
 - A range certification may be made (AFTAP is less than 60%, AFTAP is at least 60% but less than 80%, AFTAP is 80% or more, AFTAP is 100% or more) and can be used instead of a presumed AFTAP provided that the final AFTAP certification falls within the range. If there is a range certification, the actuary has until the last day of the plan year to issue the final certification. If the final certification is not issued by the end of the year, then the AFTAP will be deemed to be less than 60% as of the first day of the 10th month of the year (October 1 for a calendar year plan).
 - Under a range certification, the AFTAP is deemed to be equal to the smallest percentage within the range. This is important for determining additional IRC section 436 contributions that can be made to avoid a limitation. Contributions made to avoid a limitation that are deemed unnecessary once the final certification is done are re-characterized as contributions for minimum funding under IRC section 430.

- Any required or elected reductions in the funding standard carryover balance and prefunding balance for purposes of IRC section 436 are deemed to occur on the measurement date.
- Presumed AFTAP
 - As of the first day of the plan year, the AFTAP is presumed to be equal to the prior year AFTAP that was certified by the enrolled actuary. This presumed AFTAP applies until the actuary certifies the current year AFTAP, or until the first day of the 4th month of the year, if earlier.
 - If the current year AFTAP is not certified by the end of the third month of the plan year, the presumed AFTAP is reduced by 10 percentage points (only if the presumed AFTAP was at least 60% and less than 70%, or at least 80% and less than 90%). (This 10% reduction is done on April 1 for a calendar year plan.)
 - If the current year AFTAP is not certified by the end of the ninth month of the plan year, then the AFTAP for the current year is presumed to be less than 60% as of the beginning of the tenth month (October 1 for a calendar year plan).
 - The presumed AFTAP no longer applies beginning on the date during the plan year that the AFTAP is certified by the actuary, provided that certification occurs no later than September 30.
 - If the prior year AFTAP was certified after the 9 month deadline, then the presumed AFTAP for the current year must take into account UCE benefits permitted to be paid and plan amendments that went into effect prior to that certification date.

- Additional rules regarding presumed under-funding for IRC section 436
 - As of the first day of the year, the prior year AFTAP is presumed to be the current year AFTAP. If the presumed AFTAP would require one of the limitations under IRC section 436 to apply, then any funding standard carryover balance or prefunding balance must be reduced to the extent that it would allow the restriction to be avoided based upon the presumed AFTAP (this is done only for restrictions requiring a reduction of the credit balances if that would avoid the restriction – such as for the restriction on accelerated distributions for single employer plans). For this purpose, the adjusted value of assets as of the first day of the year are used (assuming no changes in the prefunding balance and funding standard carryover balance with regard to reductions or additions); that adjusted asset value and the presumed AFTAP are used to determine the presumed adjusted funding target (equal to the value of adjusted assets divided by the presumed AFTAP).
 - If the presumed AFTAP is less than 60% due to a non-certification of the prior year's AFTAP, then the funding standard carryover balance and prefunding balance cannot be used to prevent the IRC section 436 limitations. In addition, no additional 436 contribution can be used to avoid the limitations, other than the limitation on shutdown and UCE benefits.
 - If the current year AFTAP is not determined as of the 1st day of the 10th month of the plan year, then the AFTAP for the current year is assumed to be less than 60% as of that date.
 - Nearly under-funded plans
 - A plan is deemed to be nearly under-funded if in the prior year none of the limitations applied, but the AFTAP was not more than 10 percentage points above the percentage that would have caused a limitation to apply.
 - If the current year AFTAP is not determined as of the 1st day of the 4th month of the plan year, then the AFTAP for the current year is assumed to be 10 percentage points less than the prior year AFTAP as of that date.

- Re-certification of AFTAP (regulation 1.430-1(h)(4)(iii) and (iv))
 - The AFTAP can be re-certified due to either a correction to a prior certification or an update to a prior certification taking into account new facts that have occurred since the prior certification.
 - A material change is required to be applied retroactively to the original certification date. A change in the AFTAP is generally deemed to be material if it would cause additional restrictions to be placed on a plan (such as when the re-certified AFTAP falls in a different range than the initial AFTAP, or if the deemed AFTAP for the following year would cause the plan to fall into a different restriction range in the following year).
 - An immaterial change is applied prospectively. This can result from the recertification due to application of an additional receivable contribution for the prior year, a new election that effects the prefunding or funding standard carryover balance, or a change in the funding method, among other things.

Examples of Presumed AFTAPs

1. Given: The AFTAP for 2010 is certified on 7/1/2010 to be 65%.
The AFTAP for 2011 is certified on 7/1/2011 to be 85%.

Analysis: For 2011, the AFTAP is deemed to be 65% beginning on 1/1/2011 and is deemed to be 55% (65% less 10%) on 4/1/2011.

The restrictions when the AFTAP is at least 60% but less than 80% apply from 1/1/2011 through 3/31/2011.

The restrictions when the AFTAP is less than 60% apply from 4/1/2011 through 6/30/2011.

No restrictions apply beginning on 7/1/2011 for the balance of 2011.
2. Given: The AFTAP for 2010 is certified on 7/1/2010 to be 85%.
The AFTAP for 2011 is certified on 7/1/2011 to be 90%.

Analysis: For 2011, the AFTAP is deemed to be 85% beginning on 1/1/2011 and is deemed to be 75% (85% less 10%) on 4/1/2011.

No restrictions apply for 2011 from 1/1/2011 through 3/31/2011.

The restrictions when the AFTAP is at least 60% but less than 80% apply from 4/1/2011 through 6/30/2011.

No restrictions apply beginning on 7/1/2011 for the balance of 2011.
3. Given: The AFTAP for 2010 is certified on 7/1/2010 to be 75%.
The AFTAP for 2011 is certified on 7/1/2011 to be 90%.

Analysis: For 2011, the AFTAP is deemed to be 75% beginning on 1/1/2011 and continues to be deemed as 75% (there is no 10% reduction since the prior year AFTAP of 75% is not in the bottom 10% of a range – so that any 10% reduction would keep the AFTAP within the same range) on 4/1/2011.

The restrictions when the AFTAP is at least 60% but less than 80% apply from 1/1/2011 through 6/30/2011.

No restrictions apply beginning on 7/1/2011 for the balance of 2011.

4. Given: The AFTAP for 2010 is certified on 7/1/2010 to be 55%.

The AFTAP for 2011 is certified on 12/1/2011 to be 90%.

The AFTAP for 2012 is certified on 3/31/2012 to be 75%.

Analysis: For 2011, the AFTAP is deemed to be 55% for the entire year. This is true even though the AFTAP is eventually certified as 90% since the certification is done after the 9/30/2011 deadline. All restrictions apply for 2011.

Beginning 1/1/2012, the AFTAP for 2012 is deemed to be 90% until 4/1/2012 (when the 2012 certified AFTAP takes effect) and no restrictions apply for that period of time. The restrictions when the AFTAP is at least 60% but less than 80% apply from 4/1/2012 and for the rest of 2012.

5. Given: The AFTAP for 2010 is certified on 7/1/2010 to be 55%.

The AFTAP for 2011 is certified on 3/1/2012 to be 90%.

The AFTAP for 2012 is certified on 3/31/2012 to be 75%.

Analysis: For 2011, the AFTAP is deemed to be 55% for the entire year. All restrictions apply for 2011.

Beginning 1/1/2012, the AFTAP for 2012 is still deemed to be 55%, since the 2011 AFTAP has not yet been certified. All restrictions continue to apply.

Beginning on 3/1/2012, the 2011 AFTAP has been certified as 90%, so all restrictions are lifted until 4/1/2012 (when the 2012 certified AFTAP takes effect). The restrictions when the AFTAP is at least 60% but less than 80% apply from 4/1/2012 and for the rest of 2012.

- Shutdown benefits and other unpredictable contingent event (UCE) benefits
 - A UCE benefit is any benefit payable on account of:
 - A plant shutdown, or
 - Any event other than attainment of an age, performance of service, receipt of compensation, death, or disability.
 - UCE benefit cannot be paid to a participant if either:
 - (1) AFTAP is less than 60%, or
 - (2) The AFTAP is at least 60% but would be less than 60% after taking the UCE into account (including it as part of the funding target).
 - The restriction of payment of the UCE benefit is exempted if a contribution in addition to the minimum occurs equal to one of the following:
 - In the case where the AFTAP is less than 60% (item (1) above), an amount equal to the increase in the funding target due to the occurrence of the UCE, or
 - In the case where the AFTAP would be less than 60% after taking the UCE into account (including it as part of the funding target – item (2) above), an amount necessary to make the AFTAP equal to 60%.
 - A UCE benefit that cannot be paid due to the restrictions of this section cannot be paid at a future time even when restrictions for UCE benefits no longer apply.
 - A benefit relating to an unpredictable contingent event or plant shutdown from a year when there was no restriction of such benefit is not restricted if the plan becomes subject to this limitation in a later year.
 - The limitation of payment of UCE benefits does not apply during the first 5 years of a plan.
 - The prefunding and funding standard carryover balances cannot be used to pay for or avoid this limitation. However, the plan sponsor can elect to reduce the prefunding and/or funding standard carryover balances under IRC section 430(f)(5) in order to prevent the limitation from applying.

- Plan amendments increasing liability for benefits
 - No increases in plan benefit by amendment can take effect if either:
 - (1) AFTAP is less than 80%, or
 - (2) The AFTAP is at least 80% but would be less than 80% after reflecting the amendment.
 - The restriction on account of benefit increases is exempted if a contribution in addition to the minimum occurs equal to one of the following:
 - In the case where the AFTAP is less than 80% (item (1) above), an amount equal to the increase in the funding target due to the plan amendment, or
 - In the case where the AFTAP would be less than 80% after taking the amendment into account (including it as part of the funding target – item (2) above), an amount necessary to make the AFTAP equal to 80%.
 - The restriction does not apply if:
 - The benefit formula is not salary based, and
 - The rate of the benefit increase does not exceed the rate of average salary increase for the plan participants covered by the amendment.
 - A plan amendment that increases only future accruals and does not result in an increase in the funding target is not subject to the restrictions on plan amendments.
 - The limitation on account of benefit increases does not apply during the first 5 years of a plan.
 - The prefunding and funding standard carryover balances cannot be used to pay for or avoid this limitation. However, the plan sponsor can elect to reduce the prefunding and/or funding standard carryover balances under IRC section 430(f)(5) in order to prevent the limitation from applying.

- A restricted plan amendment that is allowed (no longer restricted) later in the same plan year due to a removal of the restriction is deemed to take effect on the original effective date of the amendment. However, if the restriction is not removed before the end of the plan year, then the amendment is deemed to have never existed (unless the amendment specifically states that it will take effect at the time that restrictions are removed).
- The effective date of an amendment for purposes of the restrictions under IRC section 436 is the date that the amendment first provides a right to an increased benefit to a plan participant or beneficiary.
 - A plan amendment that increases benefits retroactively for prior years, but only applies to participants and beneficiaries as of the date that the amendment is adopted is deemed to be effective as of the date of adoption.
 - A plan amendment that grants past service benefit increases that applies to participants and beneficiaries and is effective retroactively as of the first day (or another day) in the year is deemed to be effective as of the amendment effective date.
- Examples of restricted plan amendments
 - Increase in benefit or rate of accrual
 - Establishment of new benefits
 - Change in vesting (other than statutorily required change – if the change in vesting is required to keep the plan qualified, then it is not considered to be a restricted plan amendment)

- Accelerated benefit distributions
 - Benefit payments that are considered to be prohibited payments cannot be paid to participants whose annuity starting date occurs during any period for which benefit distributions are limited under IRC section 436(d).
 - A prohibited payment is defined to be:
 - Any payment in excess of a life annuity (including social security supplements) paid during a prohibited period.
 - A payment to purchase an annuity from an insurance company.
 - Any other payment to be specified under IRS regulations.
 - Prohibited payment cannot be paid after the valuation date on which:
 - AFTAP is less than 60%, or
 - AFTAP is less than 100% if the plan sponsor is in Chapter 11 bankruptcy.
 - Limited payments can be made if the AFTAP is at least 60% but less than 80%.
 - Plan can make what would otherwise be a prohibited payment provided it does not exceed the smaller of:
 - 50% of the payment that could be paid without restriction.
 - The present value of the maximum guaranteed PBGC benefit (this is the maximum guaranteeable benefit under ERISA section 4022(b)(3)(B) that is in effect on the annuity starting date, not adjusted for phase-in, but adjusted for the participant's age at the annuity starting date), using IRC section 417(e) assumptions (for this purpose, the segment rates published in August of the prior year are used). See PBGC Technical Update 07-4 for a description of the method used to determine the present value.
 - Only one prohibited payment can be made to any participant during any period of consecutive years for which this section applies (including years where the AFTAP was less than 60% or the plan sponsor was in bankruptcy).

- The plan sponsor **must** reduce the prefunding and/or funding standard carryover balances under IRC section 430(f)(5) to the extent that reduction would prevent this limitation from applying. This is the only restriction under IRC section 436 where there is a required reduction of the credit balance items for non-collectively bargained plans. **Important note:** The regulations under IRC section 436 state that the restriction on accelerated distributions does not apply if the plan has no form of benefit that would be subject to the restriction (such as a lump sum option). The exam general conditions state that there are no optional forms of benefit and the normal form is a life annuity. So, if an exam question does not explicitly state that there is a benefit option that would be considered an accelerated distribution, there would be no requirement to reduce the prefunding and/or funding standard carryover balance for that plan (if it is not collectively bargained).
 - Note that if the ratio of the actuarial assets (unreduced by the credit balance items) to the funding target is at least 100% (or lesser percentage as allowed under the lower transition thresholds for 2008, 2009 and 2010), then there is no deemed reduction in the prefunding or funding standard carryover balances since they have no effect on the AFTAP.
 - There is no deemed reduction of the credit balances if their total elimination would still not prevent the plan from being subject to the restrictions on accelerated distributions.
 - If the AFTAP is presumed to be less than 60% because no AFTAP certification has been done, then it is assumed that the reduction of the credit balances will not be sufficient to avoid the restrictions on accelerated distributions.
 - Any deemed reduction of the credit balances is assumed as of the AFTAP certification measurement date.

- Options for participant (required if the plan can provide only limited payment of the prohibited payment)
 - The participant must be allowed under the terms of the plan to elect to bifurcate the benefit into two pieces – the restricted and the unrestricted portions. The unrestricted portion is paid in the form elected (the form that was subject to the limitation on accelerated distributions). The restricted portion is paid in a form of annuity under the terms of the plan that is not subject to the limitation. This option is only available when the AFTAP is at least 60% and less than 80% (the case when there is a limited restriction).
 - The participant can elect to defer payment of the benefit until a later date (when plan is not subject to restrictions) provided that this does not cause a violation of any other qualification requirement (for example, minimum distributions required by IRC section 401(a)(9)) and the right to elect a deferral is a provision in the plan.
 - The participant must be permitted to elect to receive the benefit in any optional form under the plan that is not subject to the restrictions. The plan can provide that upon the date that the limitation ceases to apply to the plan, the participant can receive the remaining portion of their benefit in the original (restricted) form elected (subject to limitations of IRC section 417(e)(3) and 415(b)).

- Once the plan is no longer subject to limitations on accelerated distributions, the plan can provide that the participant can elect to receive the balance of the benefits (the amount that was restricted) in an accelerated manner. Note, however, that if this involves a plan amendment that the amendment must be considered to make certain that the plan is not then subject to the IRC section 436 restrictions on plan amendments.
- Limitations of accelerated benefit payments are not considered a violation of the protected benefit rules of IRC section 411(d)(6).
- Lump sum payments of no more than \$5,000 that are paid under the rules of IRC section 411(a)(11) can be paid even though a plan is subject to the limitations on accelerated distributions.
- The limitation of accelerated benefit distributions does not apply for any plan whose benefits have been frozen since 9/1/2005. If the plan is subsequently amended to allow for additional accruals, then the limitation becomes applicable as required by the AFTAP on the date that the plan provides for additional accruals.

- Benefit accruals for plans with severe funding shortfalls
 - Benefit accruals must be frozen as of the valuation date if the AFTAP is less than 60%. The plan also cannot be amended to increase benefits or establish new benefits while this restriction applies (even though the plan may not otherwise be restricted with regard to plan amendments under IRC section 436(c)).
 - For the plan year that begins between October 1, 2008 and September 30, 2009, if the prior year AFTAP exceeds the current year AFTAP, then the prior year AFTAP is used for purposes of the 60% test as well as possible corrections below. (Note that this is a temporary provision that applies only to the one-year period indicated.)
 - The restriction of benefit accruals for plans with severe funding shortfalls is exempted if a contribution (in addition to the minimum) is made equal to an amount that would increase the AFTAP to 60%.
 - The limitation of benefit accruals for plans with severe funding shortfalls does not apply during the first 5 years of a plan.
 - The prefunding and funding standard carryover balances cannot be used to pay for or avoid this limitation. However, the plan sponsor can elect to reduce the prefunding and/or funding standard carryover balances under IRC section 430(f)(5) in order to prevent the limitation from applying.
 - Benefit accruals must resume as of the date on which the restriction no longer applies. The plan can also be amended to restore benefit accruals that were not allowed during the period of time when IRC section 436 provided that the accruals must be frozen. However, that amendment may be subject to the IRC section 436 limitations on plan amendments that increase benefit liabilities.
 - The limitations on plan amendments can be ignored if the restriction on benefit accruals was in effect continuously for less than 12 months and the plan's AFTAP would not be less than 60% after taking into account the restoration of the past benefit accruals.

- Required use of funding standard carryover and prefunding balances to avoid limitations of IRC section 436 for collectively bargained plans
 - Reduce the prefunding and funding standard carryover balances as allowed under IRC section 430 to the extent that the reduction would avoid a limitation of IRC section 436. Note that this is a different rule from that for non-collectively bargained plans – for those plans, the reduction in the prefunding and funding standard carryover balances is only required if it would avoid the restriction on accelerated benefit payments (for plans with an accelerated benefit payment option).
 - Do not reduce the prefunding and funding standard carryover balances if a total elimination of the balances would still result in this limitation being applicable.
 - For this purpose, a plan is considered to be a collectively bargained plan if at least 50% of the employees benefiting under the plan are part of a collective bargaining unit.
- Methods of avoiding IRC section 436 limitations
 - Reduce the prefunding and funding standard carryover balances (this must be done if it will prevent the application of the limitation on accelerated benefit distributions or if it will prevent the application of any limitation for a collectively bargained plan, but is optional to avoid other restrictions for non-collectively bargained plans). Note that funding standard carryover balances are always reduced first.

- Make an additional contribution for current year as required for a specific limitation (this contribution cannot be used to satisfy the minimum funding requirement for the year and cannot be used to increase the prefunding balance). This contribution must be designated as a 436 contribution at the time it is made, and the designation cannot be changed at a later date. The deductibility of the contribution is dependent on the deduction rules of IRC section 404.
 - The contribution must be adjusted with interest at the plan's effective rate for the year if it is paid on a date other than the valuation date (increasing it with interest if it is made after the valuation date, and decreasing it with interest if it is made before the valuation date). If the plan effective rate has not yet been determined as of the date of the contribution, then the largest segment interest rate is used (generally segment 3). If the plan effective rate subsequently is found to be smaller than the segment interest rate used, then the excess contribution is re-characterized as a contribution for minimum funding under IRC section 430.
 - This contribution must be paid during the plan year.
 - The enrolled actuary must recertify the AFTAP to reflect the contribution and the impact the contribution may have had on any restrictions.
 - This method of avoiding the restrictions under IRC section 436 cannot be used to avoid the restriction on accelerated benefit distributions of IRC section 436(d).
- Make an additional contribution for prior year by the minimum funding due date (this contribution cannot be used to increase the prefunding balance).
- Provide security to be included as a plan asset.