

## **General Rules of Minimum Funding (IRC section 412)**

- The minimum funding requirement for years beginning in 2008 and later is:
  - The minimum required contribution determined under IRC section 430 for single employer plans.
    - The IRC section 430 rules apply to multiple employer plans, generally applied to each employer separately (Treasury regulation 1.430(d)-1(a)(3)). Note that a multiple employer plan is a plan that is sponsored by two or more unrelated employers. It is not a multiemployer plan, which is collectively bargained, and subject to IRC section 431.
  - The amount necessary to avoid a funding deficiency under IRC section 431 for multiemployer plans.
- The contributions must generally be made by the sponsoring employer.
  - For employers that are part of a controlled group, each employer in the controlled group may be held liable for contributions not made by other members of the group.
  - Multiemployer plans in critical status under IRC section 432 may not be held liable for required contributions if the plan adopts and complies with rehabilitation requirements under IRC section 432(e).
- Funding deficiencies
  - For a single employer plan, under IRC section 430, a funding deficiency (or the portion of the funding deficiency to be waived) is determined as of the valuation date.
  - For a multiemployer plan, under IRC section 431, or for single employer plans prior to 2008, a funding deficiency (or the portion of the funding deficiency to be waived) is determined as of the last day of the plan year.

- Waiver of minimum funding
  - All or part of the minimum funding standards may be waived by the IRS upon application by the employer.
    - The IRS cannot waive the minimum funding standard for more than 3 out of any 15 consecutive years for single employer plans (or multiple employer plans).
    - The IRS cannot waive the minimum funding standard for more than 5 out of any 15 consecutive years for multiemployer plans.
  - The waiver is amortized under the rules of IRC section 430 for single employer plans and IRC section 431 for multiemployer plans.
    - The amortization of the waived deficiency cannot be waived in a subsequent year.
  - The waiver can only be granted in the case of business hardship.
    - In the case of a single employer plan, this must be a temporary substantial business hardship. This applies to each member of the controlled group.
    - In the case of a multiemployer plan, 10% or more of the employers contributing to the plan must have a substantial business hardship based on the following factors:
      - The employer is operating at an economic loss.
      - There is substantial unemployment in the industry.
      - The sales and profits within the industry are depressed or declining.
      - It is reasonable to expect that the plan will continue only if the waiver is granted.

- Special rules for single employer plans
  - The application for the waiver must be submitted no later than 2½ months after the end of the plan year.
  - Security against the waiver may be required by the IRS.
    - The security is not required if the unpaid minimum required contribution plus the outstanding balance of prior waivers is less than \$1,000,000.
- The plan cannot be amended to increase benefit liabilities while a waiver is in effect, unless the amendment only provides for a de minimis increase in the liabilities.
- Changes in the plan year or funding method must be approved by the IRS.
- Plan amendments
  - Plan amendments adopted on or before the valuation date and effective at any time during the plan year must be used to determine valuation results.
  - Plan amendments adopted after the valuation date (and no later than 2½ months after the end of the plan year for single employer plans – 2 years for multiemployer plans) can be used to determine valuation results at the election of the plan sponsor.
  - Note that prior to 2008, Revenue Ruling 77-2 allowed for other options when the effective date of the amendment was after the first day of the plan year. These options no longer apply beginning in 2008.

- Short plan years
  - The minimum funding requirement is generally pro-rated for a short year.
    - Note that the target normal cost for a single employer plan is not pro-rated for a short plan year. The target normal cost is based upon the increase in the accrued benefit for the short year.
  - For plans terminating before the end of the plan year, the minimum funding requirement is pro-rated as if the plan year is a short year. However, the plan year remains the same, and the minimum funding and Schedule B filing deadlines remain as they would be for a full plan year. See Revenue Ruling 79-237.
- Minimum funding rules do not apply to:
  - Government plans.
  - Church plans.
  - Insurance contract plans, funded exclusively through insurance contracts that provide for level annual premium payments.

## Question 8

Plan effective date: 1/1/2005

Normal retirement benefit: 1% of final compensation per year of service

The plan does not provide for any optional forms of benefit.

Benefits are payable annually, on the first day of the year.

Actuarial assumptions for 2008:

Segment interest rates: (5.00%, 4.75%, 4.85%)

Assumed salary increases: 3.00% per year

$p_{65} = 0.995$

Annuity values at selected interest rates:

	<u>4.75%</u>	<u>4.85%</u>	<u>5.00%</u>
$\ddot{a}_{65}$	9.194	9.131	9.000
$\ddot{a}_{66}$	8.626	8.568	8.442

Data for sole plan participant Smith as of 1/1/2008:

Date of birth: 1/1/1962

Date of hire: 1/1/2003

2007 salary: \$100,000

- What is the target normal cost for Smith as of 1/1/2008?
- What is the funding target for Smith as of 1/1/2008?

## Solution to Question 8

a) The target normal cost is equal to the present value of the difference between the 12/31/2008 accrued benefit (taking into account the expected salary increase for 2008) and the 1/1/2008 accrued benefit (ignoring the expected salary increase for 2008).

$$1/1/2008 \text{ accrued benefit} = 1\% \times \$100,000 \times 5 \text{ years of service} = \$5,000$$

$$12/31/2008 \text{ accrued benefit} = 1\% \times \$100,000 \times 1.03 \times 6 \text{ years of service} = \$6,180$$

In determining the present value, the segment interest rates must be used. Smith is 46 as of 1/1/2008. The second segment interest rate is applicable for Smith's first benefit payment at age 65, and the third segment interest rate is applicable for the remaining payments beginning at age 66. The first segment interest rate is ignored because Smith will receive no benefit payments during the next 5 years.

$$\begin{aligned} \text{Target normal cost} &= (6,180 - 5,000) \times [v_{.0475}^{19} + (\ddot{a}_{66(4.85\%)} \times p_{65} \times v_{.0485}^{20})] \\ &= 1,180 \times [0.41407 + (8.568 \times 0.995 \times 0.38782)] = 4,390 \end{aligned}$$

b) The funding target is equal to the present value of the 1/1/2008 accrued benefit (ignoring the expected salary increase for 2008). In determining the present value, the segmented interest rates must be used in the same manner as for the target normal cost.

$$\begin{aligned} \text{Funding target} &= 5,000 \times [v_{.0475}^{19} + (\ddot{a}_{66(4.85\%)} \times p_{65} \times v_{.0485}^{20})] \\ &= 5,000 \times [0.414070 + (8.568 \times 0.995 \times 0.387821)] = 18,601 \end{aligned}$$