(Also see, § 7805; 26 CFR 301.7805–1.)

Phase-in of increases in funding. Questions and answers pertaining to the election to phase in increases in additional funding requirements for certain plans under section 412(l)(11) of the Internal Revenue Code as amended by the Uruguay Round Amendments Act, which includes the Retirement Protection Act of 1994, are set forth.

Rev. Rul. 96–21

PURPOSE

This revenue ruling provides questions and answers relating to the transition rule of § 412(l)(11) of the Internal Revenue Code, as amended by the Retirement Protection Act of 1994 (RPA '94), which is part of the Uruguay Round Agreements Act, Pub. L. 103–465 (GATT).

BACKGROUND

Section 412 of the Code imposes minimum funding requirements with respect to defined benefit and money purchase pension plans. Section 412(l) sets forth additional funding requirements for certain underfunded defined benefit pension plans that have more than 100 participants and that are not multiemployer plans. The additional funding requirements are in the form of an additional funding charge under § 412(l)(1) and are generally based on a plan's unfunded current liability, as defined in § 412(l)(8).

RPA '94 amended § 412(l) to modify the additional funding charge in order to produce faster funding of a plan's unfunded current liability. The amendments increased the unfunded new liability amount, changed the way in which the additional charge was integrated with the charges and credits under § 412(b), and further specified the actuarial assumptions used to determine current liability for purposes of § 412(l). RPA '94 also provided certain transition rules to be used in determining the amount of the additional funding charge.

Section 412(l)(11) of the Code provides a temporary transition rule that allows employers to phase in increases in the additional funding charge due to changes made by RPA '94. This transition rule applies for plan years beginning after December 31, 1994, and before January 1, 2002. Section 412(l)(11) provides that, at the election of the employer, the additional funding charge computed for a plan year under § 412(l)(1) shall not exceed the greater of (1) the additional funding charge for the plan year that would have been required under § 412(l)(1), as in effect prior to amendment by RPA '94, or (2) the amount that, after taking into account charges (other than the additional funding charge) and credits under § 412(b), is necessary to increase the funded current liability percentage of the plan for the plan year to the sum of the initial funded current liability percentage and the applicable number of percentage points determined under § 412(l)(11)(B).

QUESTIONS AND ANSWERS ON THE ELECTION UNDER § 412(l)(11)

Q-1. What is the election under § 412(l)(11)?

A-1. Under § 412(l)(11), an election may be made to limit the additional funding charge under § 412(l)(1) for a plan year. If the transition rule under § 412(l)(11) is elected for a plan year, the additional funding charge under § 412(l)(1) for the plan year is equal to the lesser of (1) the additional funding charge for the plan year determined without regard to § 412(l)(11), or (2) the greater of (A) the additional funding charge that would have been required for the plan year under § 412(l)(1) as in effect prior to amendment by RPA '94, and (B) the additional amount necessary to increase the funded current liability percentage of the plan to the ''target percentage'' (as defined in Q&A-6) for that plan year.

Q-2. For what plans may the election under § 412(l)(11) be made?

A-2. An election under § 412(l)(11) may be made for any ''eligible plan.'' For this purpose, an ''eligible plan'' is any plan to which § 412(l) applies for the plan year beginning in 1995, or any plan to which § 412(l) does not apply for the plan year beginning in 1995 solely by reason of the exception provided under § 412(l)(9)(B) (taking into account the special rules of § 412(l)(9)(D)). The election under § 412(l)(11) may not be made for a plan that is not an ''eligible plan.''

Q-3. For what plan years may an election under § 412(l)(11) be made for an ''eligible plan?''

A-3. For an ''eligible plan,'' an election under § 412(l)(11) may be made for any plan year beginning after December 31, 1994, and before January 1, 2002, regardless of whether an election under § 412(l)(11) has been made for any prior plan year. An election made under § 412(l)(11) for a plan year is irrevocable for that plan year.

Q-4. Who makes the election under § 412(l)(11), and must the election be reported?

A-4. Any election under § 412(l)(11) is made by the employer maintaining the plan. An election under § 412(l)(11) for a plan year is effective only if the first Form 5500 filed for the plan year reports that the election has been made for the plan year, and the Form 5500 is filed not later than the due date, including extensions.

QUESTIONS AND ANSWERS ON THE CALCULATIONS UNDER § 412(l)(11)

Q-5. For purposes of applying § 412(l)(11) to a plan year, how is the additional amount necessary to increase the funded current liability percentage of the plan to the ''target percentage'' determined for that plan year?

A-5. For purposes of applying § 412(l)(11) to a plan year, the additional amount (the ''target amount'') necessary to increase the funded current liability percentage of a plan to the ''target percentage'' for that plan year is the excess, if any, of the product of the ''target percentage'' and the ''adjusted current liability'' of the plan, over the ''adjusted assets'' of the plan.

Q-6. How is the ''target percentage'' determined for purposes of computing the ''target amount'' for a plan year?

A-6. For purposes of computing the ''target amount'' for a plan year, the ''target percentage'' for the plan year is the plan's initial funded current liability percentage, plus the applicable number of percentage points computed under § 412(l)(11)(B) for the plan year.

The plan's initial funded current liability percentage is the funded current liability percentage of the plan for the plan year beginning in 1995. This percentage is calculated as of the valuation date for that plan year, and is equal to the actuarial value of assets divided by the current liability of the plan computed under § 412(l)(7). For purposes of computing the initial funded current liability percentage, the actuarial value of assets is reduced by any credit balance in the plan's funding standard account as of the end of the prior plan year, adjusted with interest to the valuation date (using the valuation interest rate). Also, for this purpose, the current liability does not include the expected increase in current liability due to benefits accruing during the plan year beginning in 1995.

Q-7. How is the ''adjusted current liability'' determined for purposes of computing the ''target amount'' for a plan year?

A-7. For purposes of computing the ''target amount'' for a plan year, the adjusted current liability is equal to the excess of (1) the current liability of the plan for the plan year, including the expected increase in current liability due to benefits accruing during the plan year, computed under § 412(l)(7), over (2) the expected release from current liability on account of disbursements (including single sum distributions) from the plan expected to be paid after the valuation date but prior to the end of the plan year. The components of this calculation are determined as of the valuation date, and each is appropriately adjusted with interest to the end of the plan year using the interest rate used to determine current liability under § 412(l)(7).

Q-8. How are the ''adjusted assets'' determined for purposes of computing the ''target amount'' for a plan year?

A-8. For purposes of computing the ''target amount'' for a plan year, the ''adjusted assets'' are equal to the actuarial value of assets for the plan year adjusted by (1) subtracting any credit balance (or adding any debit balance) in the plan's funding standard account as of the end of the prior plan year, adjusted with interest to the valuation date at the valuation interest rate, (2) subtracting the disbursements from the plan (including single sum distributions) expected to be paid after the valuation date but prior to the end of the plan year, (3) adding the charges to the funding standard account as maintained under § 412(b) for the plan year (other than the additional funding charge under § 412(l)), and (4) subtracting the credits to the funding standard account as maintained under § 412(b) for the plan year (other than credits under §§ 412(b)(3)(A) and 412(b)(3)(C)). The actuarial value of assets and the adjustments described above are determined as of the valuation date, and each is appropriately adjusted with interest to the end of the plan year at the valuation interest rate. The result of this calculation may be a negative number, which would increase the ''target amount''.

Q-9. How is the additional funding charge that would have been required under § 412(l)(1), as in effect prior to amendment by RPA '94, determined?

A-9. The determination of the additional funding charge that would have been required under § 412(l)(1), as in effect prior to amendment by RPA '94, is the same as the determination of the additional funding charge required under 412(l)(1), as amended by RPA '94, with the following exceptions:

(1) If the current liability under § 412(l), as amended by RPA '94, is determined using an interest rate that is the highest rate in the permissible range under § 412(l)(7)(C), the current liability under § 412(l) as in effect prior to amendment by RPA '94 is determined using the interest rate used for purposes of § 412(c)(7)(A). In such a case, the latter interest rate must be the interest rate under § 412(l)(7)(C) or any higher rate permitted under § 412(b)(5)(B). On the other hand, if the current liability under § 412(l), as amended by RPA '94, is determined using an interest rate that is less than the highest interest rate in the permissible range under § 412(l)(7)(C), the current liability under § 412(l) as in effect prior to amendment by RPA '94 (and the current liability for purposes of the full funding limitation under § 412(c)(7)(A)) is determined using the same interest rate used to determine current liability under § 412(l), as amended by RPA '94.

(2) The mortality table used to determine current liability is the mortality table used to determine costs and liabilities under the plan in accordance with § 412(c)(3).

(3) In determining the additional funding charge, the deficit reduction contribution is offset under § 412(l)(1)(A)(ii) solely by amortization charges under § 412(b)(2)(B) (other than clauses (iv) and (v) thereof) and § 412(b)(2)(C) and (D), reduced by the sum of credits under § 412(b)(3)(B)(i).

(4) The amount of the additional funding charge is limited to the unfunded current liability, rather than the amount that, after taking into account charges (other than the additional funding charge) and credits under § 412(b), is necessary to increase the funded current liability percentage (taking into account the expected increase in current liability due to benefits accruing during the plan year) of the plan to 100 percent.

(5) The deficit reduction contribution under § 412(l)(2) does not include the expected increase in current liability due to benefits accruing during the plan year and the aggregate of the unfunded mortality increase amounts.

(6) The unfunded old liability amount under § 412(l)(3) is determined without including any amortization of additional unfunded old liability under § 412(l)(3)(D) or (E).

(7) The applicable percentage under § 412(l)(4)(C) for computing the unfunded new liability amount is equal to 30 percent reduced by the product of .25 multiplied by the number of percentage points by which the funded current liability percentage exceeds 35 percent.

(8) The unfunded new liability under § 412(l)(4)(B) is determined by subtracting from the unfunded current liability of the plan the unamortized portion of the unfunded old liability, the unamortized portion of the unfunded existing benefit increase liability, and the liability with respect to any unpredictable contingent event benefits (without regard to whether the event has occurred).

(9) In determining the deficit reduction contribution, any unfunded old liability base or unfunded existing benefit increase liability base continues to be amortized for the duration of the original amortization period, or until an earlier time determined under Q&A-7 of Rev. Rul. 96–20 (as those rules would be applied under § 412(l) as in effect prior to amendment by RPA '94).

(10) The unpredictable contingent event amount under § 412(l)(5) is determined without regard to § 412(l)(5)(A)(iii) and § 412(l)(5)(E).

(11) Sections 412(l)(9) and 412(l)(11), as added by RPA '94, are not taken into account.

In addition, for purposes of computing the additional funding charge that would have been required under § 412(l)(1), as in effect prior to RPA '94, the credit balance used should be the actual credit balance of the plan for the plan year.

Q-10. How is the target amount computed given the following fact pattern?

General facts:

The employer elects the transition rule under § 412(l)(11) for the 1995 plan year. The plan year is the calendar year, and the valuation date is January 1, 1995. The valuation interest rate is 8.5 percent and the § 412(l)(7)(C) interest rate is 7.93 percent.

The valuation results are as follows:

RPA '94 current liability	$1,000,000
Expected increase in current liability due to benefits accruing during the plan year	$ 70,000
Actuarial value of assets	$ 720,000
Prior year credit balance	$ 20,000
Expected disbursements (expected to be paid on 12/31/95)	$ 50,000
Expected release from current liability as a result of expected disbursements (valued as of 1/1/95)	$ 40,000
§ 412(b) charges (other than the additional funding charge), including interest to 12/31/95	$ 100,000
§ 412(b) credits, including interest to 12/31/95	$ 75,000

A-10. The ''target amount'' is the excess, if any, of the product of the ''target percentage'' and the ''adjusted current liability'', over the ''adjusted assets''.

The ''target percentage'' for the plan is the plan's ''initial funded current liability percentage'' plus the applicable number of percentage points under § 412(l)(11)(B). The plan's ''initial funded current liability percentage'' is equal to the actuarial value of assets (reduced by the prior year credit balance), divided by the plan's current liability as of the valuation date. Thus, the plan's ''initial funded current liability percentage'' is 70 percent ($720,000 minus $20,000, divided by $1,000,000), and the ''target percentage'' is 73 percent (70 percent plus 3 percent, the applicable number of percentage points under § 412(l)(11)(B)).

The ''adjusted current liability'' of the plan is equal to the excess of $1,070,000 (the sum of $1,000,000 and $70,000) over $40,000, each adjusted with interest to the end of the plan year at the § 412(l)(7)(C) interest rate. The $1,070,000 is adjusted with a full year's interest ($1,070,000 times 1.0793, or $1,154,851) and the $40,000 is adjusted with a full year's interest at the same rate ($40,000 times 1.0793, or $43,172). The resulting ''adjusted current liability'' is $1,111,679 ($1,154,851 minus $43,172).

The ''adjusted assets'' of the plan are equal to $720,000 minus $20,000, minus $50,000, plus $100,000, minus $75,000, each adjusted with interest from the appropriate date to the end of the plan year at the valuation interest rate. The $720,000 and $20,000 as adjusted with a full year's interest at the valuation interest rate equals $759,500 ($720,000 minus $20,000, times 1.085). The $50,000 receives no interest adjustment, as benefit payments are expected to be paid at the end of the year. The charges and credits already are calculated with interest to the end of the year. The resulting ''adjusted assets'' is $734,500 ($759,500, minus $50,000, plus $100,000, minus $75,000).

The ''target amount'' is equal to the excess of the product of 73 percent (the ''target percentage'') and $1,111,679 (the ''adjusted current liability''), over $734,500 (the ''adjusted assets''), or $77,026.

APPLICATION OF § 7805(b)

Pursuant to § 7805(b), this revenue ruling shall not be applied for purposes of determining the amount of any required installment under § 412(m)(4), if the due date for that required installment is on or before April 15, 1996.

DRAFTING INFORMATION

The principal author of this revenue ruling is Martin L. Pippins of the Employee Plans Division. For further information regarding this revenue ruling, please contact the Employee Plans Division's taxpayer assistance telephone service between 2:30 p.m. and 4:00 p.m. Eastern Time, Monday through Thursday on (202) 622-6076 (Actuarial Hotline) (not a toll-free telephone number). Mr. Pippins' telephone number is (202) 622-6261 (also not a toll-free number).