eBenefits Alert: IRS Releases Final 415 Regulations: Changes Affecting Defined Contribution Plans

June 1, 2007

On April 5, 2007, the IRS and the U. S. Treasury Dept. released final regulations under Code Section 415. The final regulations incorporate and expand the May 2005 proposed regulations and add new provisions to deal with changes included in the Pension Protection Act of 2006. Comprehensive regulations under Code Section 415 were last issued in 1981. Since that time most IRS guidance has been in the form of Notices and Revenue Rulings. The final regulations consolidate these rules and adopt additional changes.

Background. Code Section 415 establishes limits on the annual benefits that may be provided under a qualified defined benefit plan and on contributions and other annual additions to a qualified contribution plan. The definition of 415 compensation is also used for a number of other purposes under the Code, including determining the limits on deductions for contributions to a plan under Code Section 404, determining whether an employee is highly compensated within the meaning of Code Section 414(q), and determining nondiscriminatory compensation for purposes of applying the ADP, ACP and other nondiscrimination tests.

Effective Date. The final regulations are effective for limitation years beginning on or after July 1, 2007. For calendar year plans, this means that the new rules will be effective January 1, 2008. Plans have the option of applying the post-severance compensation rules earlier than the regular effective date. There is a delayed effective date for governmental plans.

Highlights. The final regulations are extensive and affect both defined contribution plans and defined benefit plans. However, two of the key changes to defined contribution plans relate to post-severance compensation and deferrals.

Post-severance Compensation. The final rules limit a plan's ability to count compensation after a participant severs employment. In general, under the new regulations, compensation does not include compensation paid after an employee severs employment. However, there are exceptions for compensation paid to former employees who are in the US military or those who are permanently and totally disabled, and for certain compensation paid by the later of 2½ months after severance of employment or the last day of the limitation year in which the employee severed employment (if the employee would have received the payments at the same time if employment had continued). Compensation does not include any of the following amounts paid after employment termination: severance pay, parachute payments, or payments from unfunded deferred compensation plans which are "triggered" by severance.

Deferrals. 401(k) and 457(b) plans cannot accept deferrals from amounts which are not compensation under the revised rules. Thus, post-severance compensation that does not meet one of the above exceptions cannot be deferred into a 401(k) or 457(b) plan.

Plan Amendments. Plan sponsors will need to review their documents to determine if amendments are needed to comply with the new rules. Plans sponsored by employers operating on a calendar taxable year will generally need to be amended to comply with the final regulations by the deadline for filing the employer's income tax return (including extensions) for the 2008 taxable year.

Please contact a member of the Gray Plant Mooty Employee Benefits and Executive Compensation group for more information about the final regulations and how they may affect your retirement plan.

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