

IRS Provides 412(i) Plan Audit Clarification

By Bruce Ashton

We recently received an important clarification from the IRS on one of the points made in our recent bulletin regarding 412(i) plan audits (“Terms for Resolving 412(i) Audits,” ERISA Audit Bulletin, February 13, 2007, http://www.reish.com/publications/article_detail.cfm?ARTICLEID=638). We don’t much like the news, but we certainly appreciate the Service taking the time to review and comment on our bulletin.

Ms. Karen Justesen, Supervisor of field actuaries at the IRS, advises that if a plan sponsor wishes to retroactively convert an existing 412(i) plan to a standard defined benefit pension plan (a non-412(i) plan), the IRS will generally not approve an amendment to the document to change the benefit formula or other plan provisions that affect the funding.

For example, suppose the plan provides for a retirement benefit equal to 35% of final average pay and a normal retirement age of 65. In converting to a non-412(i) plan, it may not be possible to amend the plan retroactively to provide for a benefit equal to 100% of final average pay or a lower retirement age, such as 62.

On the other hand, because the plan was not funded using actuarial assumptions, the plan actuary is free to

adopt reasonable assumptions to be used in determining the contributions for prior years (including potentially a different retirement age than that specified in the plan).

As we noted in the prior bulletin, the process of conversion, including a review of the plan document and establishing of actuarial assumptions, should not be attempted without a combination of actuarial skill and creativity and legal input to avoid pitfalls and maximize the conversion opportunity.

Ms. Justesen also indicated that an abusive (vs. a merely non-compliant) 412(i) plan may not be retroactively converted if it contains any other qualification failures. Even though a merely non-compliant plan may retroactively correct such failures, the only option available for abusive plans is to unwind them and pay applicable taxes, interest and penalties.

If you would like to discuss these issues, please contact one of the members of our 412(i) audit team, Bruce Ashton (BruceAshton@Reish.com), Marty Heming (MartyHeming@Reish.com), or Heather Bader-Abrigo (HeatherAbrigo@Reish.com).

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