

IRS posts guidance on HATFA interest rate change for defined benefit plans

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In brief

In [Notice 2014-53](#), the IRS has provided guidance on recently-enacted interest rate smoothing provisions for defined benefit plans, allowing plan sponsors until December 31, 2014 to make certain decisions and elections as to when and how to apply the new rates. The new interest rates affect the calculation of minimum required contributions beginning with the 2013 plan year, as well as the determination of a plan's adjusted funding target attainment percentage (AFTAP) for purposes of the Code section 436 restrictions on underfunded plans. Notice 2014-53 provides transition guidance on the effect of the changes for 2013 and 2014 plan years, addressing elections that may be made and the effect on plan funding and benefit restrictions.

In detail

Background

The Highway and Transportation Funding Act of 2014 (HATFA) extended the interest rate smoothing provisions originally enacted in the Moving Ahead for Progress in the 21st Century Act of 2012 (MAP-21). Under MAP-21, defined benefit plan funding requirements are determined based on adjusted segment rates that fall within a specified range of the 25-year average rates on corporate bonds for each segment of the yield curve. The specified range was scheduled to increase from 90 to 110% of the 25-year average in 2012 to 70 to 130% of the 25-year average in 2016. HATFA modified the

increase in the range around the 25-year average, so that the range continues to be 90 to 110% for an additional 5 years beyond 2012. The range will gradually increase beginning in 2018, reaching 70 to 130% of the 25-year average rates for plan years beginning after 2020.

Observation

The tighter the range, the closer the interest rate must be to the actual 25-year average rates, giving more effect to interest rates in the earlier part of the past 25 years and stabilizing volatility in rates over time. The range for 2013 under MAP-21 was 85 to 115% of the 25-year average rates; HATFA tightens the range for 2013 retroactively back to 90 to 110%.

Notice 2012-61 provided guidance on the modified segment rates under MAP-21. New Notice 2014-53 provides comparable guidance on the HATFA segment rates, modifying the earlier notice based on the new statute. Under HATFA, the changes to the interest rates apply for plan years beginning after December 31, 2012, but a plan sponsor may elect not to have these modifications apply to any plan year beginning in 2013, either for all purposes, or solely for purposes of determining the plan's AFTAP for the year for purposes of the benefit restrictions under Code section 436. The HATFA rates are required for 2014 plan years.

Notice 2014-53

Elections to defer use of HATFA segment rates until the 2014 plan year. Under HATFA, a plan sponsor may elect to defer the use of the HATFA rates either for all purposes or solely for purposes of the benefit restrictions, until the 2014 plan year. Notice 2014-53 provides that this election may be made by providing written notice to the enrolled actuary and to the plan administrator specifying the name of the plan, the EIN and plan number, and whether the HATFA rates are being deferred for all purposes or only for purposes of determining the AFTAP. The election is irrevocable and must be made by the later of the deadline for filing the annual reports for the 2013 plan year (the Form 5500 series), or December 31, 2014.

A plan sponsor that wishes to defer the use of the HATFA segment rates both for funding and for benefit restriction purposes will be deemed to have made that election if the Form 5500 series is filed for the year and the Schedule SB reflects the MAP-21 rates. This deemed election may be revoked by filing amended forms no later than December 31, 2014 with a revised Schedule SB reflecting the HATFA rates, or by filing a written notice with the enrolled actuary and the plan administrator, and emailing a copy to the PBGC. A plan sponsor who wishes to revoke a deemed election and to defer the HATFA rates only for purposes of determining the AFTAP rather than for all purposes may do so. This election must be made by written notice to the actuary and plan administrator, emailed to the PBGC at revoke.deemed.HATFA.election@pbgc.gov, on or before December 31, 2014, and is not available if the plan sponsor is in bankruptcy. In the case of a revocation by written notice, an amended Form 5000 and Schedule SB reflecting the HATFA rates must be

filed by the time for filing for the following plan year.

Observation

The deemed election rules are welcome and will make it easier for plan sponsors who do not wish to have to redo their already completed 2013 valuations and annual reports. Although practitioners had asked IRS and Treasury to provide that the HATFA rates need not apply to 2014 if the sponsor doesn't wish to change the minimum funding obligation or increase the funding balance, the Notice does not provide this flexibility. Accordingly, valuations already done for the 2014 plan year will need to be redone to reflect the HATFA segment rates.

Funding elections and redesignations available for the 2013 plan year. Notice 2014-53 sets forth rules for elections and designations relating to the minimum funding requirements for the 2013 plan year.

Plan sponsors may elect to reduce the plan's funding standard carryover balance or prefunding balance ('funding balances') in order to increase the value of assets for purposes of minimum funding and AFTAP calculations. Under the regulations, such an election is generally irrevocable. Notice 2014-53 permits an election to reverse all or part of an election to reduce these balances that was made by September 30, 2014, if the plan has not deferred the HATFA segment rates for minimum required contribution calculations for the 2013 plan year. A deemed election to reduce these balances to avoid or remove benefit restrictions under Code section 436 after the date of the original AFTAP certification for the year may also generally be reversed.

Plan sponsors may elect to add excess contributions for a year to the plan's

prefunding balance as of the first day of the next year. Notice 2014-53 extends the time for making this election. If the HATFA rates are applied retroactively to the 2013 plan year, and a contribution that was necessary to avoid or remove a benefit restriction is no longer necessary, the contribution is applied toward the minimum required contribution for that plan year. This treatment will not apply to contributions made in connection with a presumed AFTAP for the year before the AFTAP was certified.

Under the Code, for funding purposes, a contribution made by the time for filing the corporation's income taxes for a year may be applied retroactively back to the beginning of the plan year that ends with or within the tax year. These contributions are to be reflected on the Schedule SB filed with the Form 5500 for the year. Plan sponsors may have made contributions for their 2013 plan years in 2014 that are no longer necessary to satisfy the minimum funding requirements after application of the HATFA segment rates. Notice 2014-53 permits a plan sponsor to redesignate a contribution made by the end of September 2014 to apply to the 2014 plan year rather than to the 2013 plan year, as long as an amended Schedule SB for the 2013 plan year is filed on or before December 31, 2014.

Observation

The Notice refers to the IRS' relatively recent position, which is not set forth officially in regulations, that a contribution designated for a particular plan year cannot be redesignated to apply for another plan year after the original Schedule SB has been filed.

Any election, reversal of an election or redesignation of a contribution must be made by the plan sponsor by

providing written notification to the plan's enrolled actuary and plan administrator no later than the last day of the plan year beginning in 2014.

Reporting requirements. If the HATFA segment rates apply to the 2013 plan year (i.e., the plan sponsor does not make the elections discussed above), the Schedule SB for 2013 must reflect the use of the HATFA segment rates.

AFTAP measurements and benefit restrictions for plan years beginning after December 31, 2012 and before October 1, 2014. Notice 2014-53 provides special rules relating to the benefit restrictions under Code section 436 for certain plan years for which the HATFA rates are applied to the AFTAP determination for the year. The HATFA rates do not affect the application of the presumed AFTAP rules for periods in the plan year before the AFTAP has been certified (but will affect the presumptions for the following plan year).

If the first AFTAP certification for the plan year uses the HATFA rates, the benefit restrictions apply based on that AFTAP. If the first certification for the year is made using the MAP-21 rates, the AFTAP must be redetermined using the HATFA rates. If this results in a material change to

the AFTAP (i.e., one that requires different treatment of benefit restrictions), the AFTAP must be recertified. In certain cases, the plan sponsor may choose to apply the resulting change in the application of the benefit restrictions prospectively from the date of the recertification, or retroactively to the date of the original AFTAP certification. Notice 2014-53 provides very specific rules concerning this election and the effect on the plan, and requires changes in benefit restrictions resulting from an updated AFTAP determination to be effective as of the earlier of October 1, 2014 or the date the AFTAP is recertified using the HATFA segment rates, although the recertification itself may be made as late as December 31, 2014.

Plan operations must be conformed to an updated AFTAP determined using the HATFA segment rates, and the redetermined AFTAP will apply for purposes of the presumed AFTAP rules for the 2014 plan year. Once the AFTAP has been recertified using the HATFA segment rates, the plan administrator must take any corrective actions necessary to conform plan operations to this certified AFTAP, including paying any restricted benefit retroactively.

Observation

Where a plan was prevented from making a prohibited payment such as a lump sum distribution based on the original MAP-21-based AFTAP but this distribution is permitted after recertifying the AFTAP using HATFA rates, the plan must make the prohibited payment available to participants and beneficiaries whose payments were restricted, in accordance with the Notice.

No reversal of an election to reduce funding balances or to redesignate contributions to the 2014 plan year may be made if the effect would be to impose benefit restrictions that would not otherwise have been imposed.

The takeaway

Notice 2014-53 provides some breathing room for plan sponsors, allowing many elections to be made as late as December 31, 2014 and permitting changes in elections made in accordance with calculations made for 2013 based on MAP-21 segment rates. It is very important for plan sponsors to consult with their enrolled actuaries concerning the effect of these changes, and of course to discuss the revised calculations and valuations necessitated by the new law.

Let's talk

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