

August 2005

## IRS Now Allows Elimination of Optional Pension Forms

One problem that plagues many pension plans is the accumulation of "protected" forms of benefit. These are often unusual annuity forms-typically inherited from other plans that have been merged as part of historical acquisitions-that participants almost never elect but that have to be kept in the plan because ERISA generally prohibits the elimination of any form of payment for benefits that have already accrued.

These protected forms of benefit can cause significant complications and expense in pension plan administration, even if retirees rarely elect them. Recognizing this problem, Congress, as part of the enactment of EGTRRA in 2001, directed the IRS to issue regulations allowing the elimination of redundant and unnecessary benefit forms. The IRS has recently released both final and proposed regulations, which offer plan sponsors an opportunity to simplify their defined benefit pension plans.

Defined contribution plans are generally not affected by these new regulations. However, other provisions of EGTRRA, which have already taken effect, allow the elimination of many formerly protected benefits under defined contribution plans.

The issuance of the new protected benefit regulations coincides with the delayed effective date of the relative value regulations released last year. (To view the July 2004 Management Alert on the relative value regulations, click [here](#).) The relative value regulations, which were originally scheduled to take effect in 2004, require plan sponsors to disclose the relative actuarial values of different benefit elections available to retirees. The IRS postponed the effective date of the regulations (except with respect to lump sum options and pretirement survivor annuities) to February 1, 2006, in part because the protected benefit regulations were pending. Thus, plan sponsors whose plans contain little-used benefit options may wish to consider eliminating those options before finalizing their relative value disclosures.

### Plant Shutdown Benefits - December 31, 2005 Deadline

The regulations generally apply to any amendment adopted after August 12, 2005 (although there may be delays in the effective date of certain benefit eliminations that can be as long as four years). There has been some question whether the rule prohibiting the elimination of protected benefits applied to plant closing and other contingent event benefits at all, at least if the amendment eliminating the benefit was adopted before the contingent event occurred.

The new regulations clearly provide that contingent event benefits are a protected form of benefit, but generally allow employers to eliminate such benefits if the amendment is adopted by December 31, 2005. Accordingly, employers who wish to eliminate such benefits need to analyze their pension plans and prepare amendments before year end. The regulations have no extended amendment date for collectively bargained plans and thus elimination of plant shutdown benefits may be impractical in union plans.

### Benefits that Can Be Eliminated

The regulations permit otherwise protected benefits to be eliminated in three circumstances:

- ♦ **Redundant Benefits.** A benefit form can be eliminated if the plan retains at least one form that is in the same "benefit family" and is otherwise the same as the form being eliminated. For example, the regulations specify that term certain annuities with guaranteed periods of 10 years or less, or more than 10 years, are two different benefit families. Therefore, a plan that offered a 10-year certain, 15-year certain, and 20-year certain annuity could eliminate either the 15-year or 20-year (but not both), but could not eliminate the 10-year. Redundant benefits can generally be eliminated on 90 days notice.

- ◆ **Non-Core Benefits.** A plan that offers a selection of “core” benefit options can eliminate all non-core benefits other than lump sum options after a four year phase in period. The core benefits are straight life, 10 year certain, and either a joint and 75% or both a joint and 50% and joint and 100% survivor annuity (for both spouses and nonspouse beneficiaries). Lump sum options generally cannot be eliminated under this rule. This approach may be useful for companies that frequently merge acquired plans into their plan. The new regulations may complicate the due diligence process in acquisitions involving pension plans, by requiring the acquirer to examine the net effect of amendments adopted in prior years.
- ◆ **Low-Value Subsidies.** Under this rule, a plan can eliminate early retirement benefits and retirement subsidies (for example, by changing actuarial assumptions) if including multiple forms of benefit in the plan can be shown to be burdensome and complex and the form of benefit being eliminated has a minimal actuarial value. The first part of the test is based on facts and circumstances, but the second part will require an actuarial calculation. This may be particularly useful for plans that are merged with acquired plans that contain different actuarial reduction factors for early retirement benefits.

## Other Proposed Regulations

In addition to the final regulations summarized above, the IRS has also issued two proposed regulations dealing with the elimination of optional benefit forms. The first would permit an option to be eliminated if the option has been available to at least 100 retirees over a look-back period of at least two years (or up to 5 years, if needed) but was never elected. However, if the plan has a lump sum option, retirees who elect the lump sum are not counted toward the 100 retirees for whom the optional benefit was available, which could make this test unavailable for most cash balance plans. Hopefully this aspect of the test will be modified before the regulations are finalized.

The second proposed regulation implements the decision of the Supreme Court last year in *Central Laborers’ Pension Fund v. Heinz*. In *Heinz*, the Court held that a plan amendment that imposed restrictions on the receipt of a pension - specifically, a provision that suspended pension payments to a re-employed retiree - violated the rule against the reduction of accrued benefits. The IRS guidance also permits a plan that had adopted such an amendment prior to the *Heinz* decision to reverse the amendment without being disqualified.

*If you have any questions concerning elimination or reduction of optional forms of benefit or retirement type subsidies in pension plans, please contact the Seyfarth Shaw LLP Employee Benefits Group attorney with whom you work or any Employee Benefits attorney on the website at [www.seyfarth.com](http://www.seyfarth.com).*

---

This newsletter is a periodical publication of Seyfarth Shaw LLP and should not be construed as legal advice or a legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult a lawyer concerning your own situation and any specific legal questions you may have. For further information about these contents, please contact the firm’s Employee Benefits Practice Group.

### ATLANTA

One Peachtree Pointe  
1545 Peachtree Street, N.E., Suite 700  
Atlanta, Georgia 30309-2401  
404-885-1500  
404-892-7056 fax

### BOSTON

Two Seaport Lane, Suite 300  
Boston, Massachusetts 02210-2028  
617-946-4800  
617-946-4801 fax

### CHICAGO

55 East Monroe Street, Suite 4200  
Chicago, Illinois 60603-5803  
312-346-8000  
312-269-8869 fax

### HOUSTON

700 Louisiana Street, Suite 3700  
Houston, Texas 77002-2797  
713-225-2300  
713-225-2340 fax

### LOS ANGELES

One Century Plaza  
2029 Century Park East, Suite 3300  
Los Angeles, California 90067-3063  
310-277-7200  
310-201-5219 fax

### NEW YORK

1270 Avenue of the Americas, Suite 2500  
New York, New York 10020-1801  
212-218-5500  
212-218-5526 fax

### SACRAMENTO

400 Capitol Mall, Suite 2350  
Sacramento, California 95814-4428  
916-448-0159  
916-558-4839 fax

### SAN FRANCISCO

560 Mission Street, Suite 3100  
San Francisco, California 94105  
415-397-2823  
415-397-8549 fax

### WASHINGTON, D.C.

815 Connecticut Avenue, N.W., Suite 500  
Washington, D.C. 20006-4004  
202-463-2400  
202-828-5393 fax

### BRUSSELS

Boulevard du Souverain 280  
1160 Brussels, Belgium  
(32)(2)647.60.25  
(32)(2)640.70.71 fax