

SECTION 404(o)

Maximum Deductible Contributions

Single Employer Plans

DEDUCTIBLE LIMITS**SINGLE EMPLOYER DB PLANS**

404(a)(1)(A) General rule:

Multiemployer plans

**404(a)(7) Limitation on deduction for
combination of DC and DB plan**

404(l) Limitation on compensation

**404(m) Elective deferrals not taken into
account**

**404(o) Deduction limit:
Single employer plans**

**404(o) calculations ignore higher segment
rates under MAP-21, which gives larger
deductible limit**

§404(o)(1)

GENERAL RULE

Deductible limit

Equals the greater of

- 1. The excess (if any) of the sum of
 -) Funding target for the plan year, plus**
 -) Target normal cost for the plan year, plus**
 -) Cushion amount for the plan year****Over the 430(g)(2) actuarial value of assets****
- 2. Minimum required contributions under IRC section 430**

NOTES:

-) No reduction in AAV for CB/PB under 404**
-) Should reduce AAV for non-deducted contributions (old 404 regulation)**

§404(o)(3)

CUSHION AMOUNT

Cushion Amount equals the sum of

-) 50 percent of the funding target for the plan year, and**
-) Increase in funding target if the plan allowed for future compensation increases**
-) Plan benefits not compensation-based
 - Allow for expected future increases in benefits**
 - Based on average annual increase over prior 6 plan years****

§404(o)(3)

COMPENSATION AND BENEFIT LIMITS

Must allow for 404(l) compensation limit and 415(b) benefit limits

If plan is covered by PBGC, can project future increases in 404(l) compensation limit

2015 EXAM CONDITION

58. Plan is covered by the PBGC

§404(o)(4)

CUSHION AMOUNT – TWO YEAR RULE

Plans with 100 or less participants

) Reduce “Target liability” (undefined)

) Excludes benefit increases for HCEs due to plan amendment made (or effective), within the last 2 years

PRACTICAL NOTE

Notice 2007-28 Q&A-5:

Adoption of new plan not treated as plan amendment if the employer did not maintain a defined benefit plan covering any HCE covered by the new plan during the past 2 years (tax years)

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§414(q) HIGHLY COMPENSATED EES (HCE)

***** TOPIC COVERED ON EA-2L EXAM *****

**Can be HCE solely based on stock ownership,
or based on pay**

§414(q)(1)(A)	"5% owner" during current or prior year, <u>OR</u>
§414(q)(1)(B)(i)	Employee with prior year compensation in excess of 120,000, AND
§414(q)(1)(B)(ii)	If the employer elected this clause in prior year, was in top-paid group in prior year

§414(q) HIGHLY COMPENSATED EES (HCE)

***** TOPIC COVERED ON EA-2L EXAM *****

§414(q)(1)(A)

-) IRC §318 Constructive ownership rules apply
-) IRC §416 defines this as "greater than 5%"

§414(q)(1)(B)(i)

HISTORICAL VALUES

2015	120,000
2016	120,000
2017	120,000

-) For non-calendar year plan year, use value for calendar year in which plan year starts

§414(q)(1)(B)(ii)

-) The top-paid group is the highest 20% of employees, ranked by compensation

§404(o)(4)

CUSHION AMOUNT – TWO YEAR RULE

Determination of participant count - for small plan HCE liability exclusion

-) Include all non-multiemployer DB plans in controlled group**
-) Only count participants of employer**

Use participant count “for the plan year” - no date is specified (current year assumed)

§404(o)(1)

GENERAL RULE - EXAMPLE

	PLAN 1	PLAN 2
Target Normal Cost	80	120
Funding Target	350	300
Funding target with Compensation increases	400	350
50%*Funding Target Increase in Funding Target: compensation increases Cushion amount		
NC + FT + Cushion amount AAV - zero Deductible limit	<u>300</u>	<u>400</u>

§404(o)(2)(B)

SPECIAL RULE FOR "NOT AT-RISK" PLANS

IF a plan is not at-risk under IRC Section 430(i), have a third definition for deductible limit:

The excess (if any) of the sum of

-) Funding target for the plan year, assuming at-risk rules apply, plus**
-) Target normal cost for the plan year, assuming at-risk rules apply**
-) Over the 430(g)(2) actuarial value of assets**

§404(o)(2)(B)

SPECIAL RULE FOR "NOT AT-RISK" PLANS

	PLAN 1	PLAN 2
NC + FT + Cushion amount	655	620
AAV - zero	<u>300</u>	<u>400</u>
Deductible limit	355	220
At-Risk results		
Target Normal Cost	128	192
Funding Target	560	480
AAV - zero	<u>300</u>	<u>400</u>
"At-risk" Deductible limit	388	272
"Final" Deductible limit	388	272

2017 GENERAL CONDITIONS – FUNDING SINGLE EMPLOYER PLANS

- 38. The employer is taxable, and all employer contributions for each prior plan year have been deducted by the employer for its tax year coincident with such plan year**
- 45. The plan is not currently in “At-Risk” status (nor has it ever been)**
- 46. “At-Risk funding target” and “At-Risk target normal cost” mean the values reflecting the additional actuarial assumptions and loading factors (if applicable), but prior to weighting of liabilities under the five year transition rule**

NOTE

Exam problems have not consistently used the descriptive terms in exam condition 46!

(45 and 46 from overhead page 430(i)-19)

§404(o)(2)(B)

SPECIAL RULE FOR "NOT AT-RISK" PLANS

) Approach #1

Use 100% of the At-Risk values of the Target normal cost and Funding Target, with no weighting of the non At-Risk values

) Approach #2

IRC 404 At-Risk values reflect weighting between the At-Risk values and the non At-Risk values, based on the number of years the plan has actually been At-Risk

If problem gives "At-risk Funding target / Target normal cost for IRC section 404 purposes", you should assume values have been adjusted already (using one of these two approaches)

Example – 2007 exam problem #3

§404(o)(5)

SPECIAL RULE FOR TERMINATING PLANS

-) Can always deduct amount required to make plan sufficient for benefit liabilities under ERISA 4041(d)**
-) Plan must be covered by PBGC**

2017 EXAM CONDITION

58. Plan is covered by the PBGC

ACTUARIAL ASSUMPTIONS

Deductible limit calculations for any plan year must use the "same" actuarial assumptions which are used for the minimum contribution under section 430

Higher segment rates under 430(h)(2)(C)(iv) are ignored - gives larger deductible limit

§404(o)(7)
DEFINITIONS UNDER 430

Any term used in this subsection which is also used in section 430 shall have the same meaning given such term by section 430

§404(a)(12)

DEFINITION OF COMPENSATION

Now include amounts treated as participant's compensation in §415(c)(3):

-) §125 Cafeteria plans (includes §401(k))**
-) §132 Fringe benefits (includes ee discounts)**
-) §402(g)(3) Elective deferrals**
 - ER contribution under Cash or Deferred Arrangement (§401(k))**
 - §408(k) SEP contributions**
 - §403(b) salary reduction annuities**
 - §408(p) elective IRA contributions**
-) §457 Deferred compensation plans**

404(a)(8)

SPECIAL RULE FOR SELF-EMPLOYED

401(c)(1) Also for owner-employee

Compensation = Earned Income, defined as Gross Income less all deductions (includes pension contributions)

This compensation is used for

-) Plan benefits**
-) §415 Benefit Limits**
-) §404 Deduction Limits**

This can make §404 limit calculations iterative

§401(a)(17) COMPENSATION LIMIT

§401(a)(17) defines includable compensation. DB plan benefits (or DC allocations) can't use pay over this amount:

2015-2015	265,000
2016-2016	265,000
2017-2017	270,000

HISTORY

After COLA applied to base, resulting figure is rounded to lower \$5,000

EGTRRA increased base amount - \$200,000 usually retroactive to all years before 2001

§404(I) LIMIT ON COMPENSATION

**Adjusted similar to 401(a)(17) includible
compensation limit:**

2015-2015	265,000
2016-2016	265,000
2017-2017	270,000