

MEMO# 13672

June 22, 2001

IRS ISSUES FINAL REGULATIONS ON TRANSFER OF PENSION ASSETS TO HEALTH ACCOUNTS

[13672] June 22, 2001 TO: PENSION COMMITTEE No. 39-01 RE: IRS ISSUES FINAL REGULATIONS ON TRANSFER OF PENSION ASSETS TO HEALTH ACCOUNTS The Internal Revenue Service recently issued final regulations permitting the transfer of excess assets of a defined benefit plan to a retiree health account. These regulations provide that the minimum cost requirement of section 420(c)(3) of the Code is not met if an employer significantly reduces retiree health coverage during the cost maintenance period. Whether an employer has significantly reduced retiree health coverage is determined by looking at the number of individuals (retirees, their spouses and dependents) who lose coverage during the cost maintenance period as a result of employer actions, measured on both an annual and on a cumulative basis. Section 420 permits employers to transfer excess defined benefit plan assets to fund retiree health benefits without incurring tax or penalties. Such qualified transfers are conditioned on the employer maintaining employer-provided retiree health expenditures at a minimum dollar level for a five-year cost maintenance period. The final regulations provide the standards for when an employer has significantly reduced retiree health coverage during the maintenance period. According to the regulations, an employer does not satisfy the minimum cost requirement if the percentage decrease in the number of individuals provided with applicable health benefits that is attributable to employer action exceeds 10% in any year, or exceeds 20% during the five-year period. The final regulations, similar to the proposed regulations, provide that "employer action" includes not only plan amendments but also situations in which other employer actions, such as the sale of all or part of the employer's business, operate in conjunction with the existing plan terms to have the indirect effect of ending an individual's coverage. The final regulations, however, include a special rule that allows the employer to treat retiree health coverage as not having ended for individuals whose coverage is provided by a buyer of the business. If the buyer discontinues these benefits, the employer must treat those individuals as having lost coverage because of employer action. The final regulations also clarify that the rule for sales applies to other transfers of a business. The regulations are effective June 19, 2001 and are applicable to transfers of excess pension assets occurring on or after December 18, 1999. The final regulations do, however, take into account any reinstatement of coverage that occurs during the portion of the cost maintenance period that precedes the first day of the first tax year beginning after 2001. A copy of the final regulations is attached. Kathryn A. Ricard Associate Counsel Attachment Attachment (in .pdf format)

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