

**MEMO# 12998**

January 9, 2001

# **IRS ISSUES PROPOSED REGULATIONS ON TRANSFER OF EXCESS DEFINED BENEFIT PLAN ASSETS TO RETIREE HEALTH ACCOUNTS**

[12998] January 9, 2001 TO: PENSION COMMITTEE No. 1-01 RE: IRS ISSUES PROPOSED REGULATIONS ON TRANSFER OF EXCESS DEFINED BENEFIT PLAN ASSETS TO RETIREE HEALTH ACCOUNTS The Internal Revenue Service has issued proposed regulations on the "minimum cost requirement" relating to the transfer of excess assets of a defined benefit pension plan to a retiree health account under Code section 420. Specifically, the proposed regulations provide that an employer that significantly reduces retiree health coverage during the "cost maintenance" period does not satisfy the minimum cost requirement of section 420(c)(3). The proposed regulations also clarify the circumstances under which retiree health coverage has been "significantly reduced." Comments to the proposed amendments must be received by March 6, 2001. A public hearing on the proposed regulations also is scheduled for March 15, 2001; requests to speak at the hearing must be received by February 21, 2001. Section 420 was added to the Code in 1990 as a temporary provision permitting certain qualified transfers of excess pension assets from a non-multiemployer defined benefit plan to a health benefits account that is part of the plan. Section 420 contains a minimum cost requirement, under which an employer that transfers excess pension assets must maintain retiree health expenditures at a minimum dollar level for a 5-year cost maintenance period with respect to covered retirees, their spouses and dependents. The provision was extended and modified by subsequent legislation, including the Tax Relief Extension Act of 1999, which extended section 420 through December 31, 2005.<sup>1</sup> The proposed regulations provide that the minimum cost requirement of section 420(c)(3) would not be satisfied if the employer significantly reduces retiree health coverage during the cost maintenance period. Whether this occurs depends on the number of individuals that lose coverage during the cost maintenance period: an employer would not satisfy the minimum cost requirement if the percentage decrease attributable to employer action in the number of covered individuals exceeds 10 percent in any year, or if the sum of the annual percentage decreases during the cost maintenance period exceeds 20 percent. The 10 percent annual limit would not apply to a taxable year that begins before February 5, 2001. <sup>1</sup> See Institute Memorandum to Pension Members No. 46-99 and Pension Operations Advisory Committee No. 58-99, dated December 17, 1999. <sup>2</sup> "Employer action" would be broadly defined under the proposed regulations. Employer activities that, in conjunction with existing plan terms, have the effect of ending an individual's coverage, such as the sale of all or part of the employer's business, would constitute employer action. The term also would cover plan amendments, including amendments executed before the

cost maintenance period, but becoming effective during the period (unless the amendment occurred before the later of December 18, 1999, and 5 years before the start of the cost maintenance period). Additionally, when an individual's coverage ends due to a sale of all or part of the employer's business, that individual would be treated as having lost coverage by reason of employer action. No exceptions would be provided, even if the buyer provides coverage for such individuals. With respect to this proposed rule, the Service specifically requests comments as to (1) the circumstances, if any, in which buyers commonly provide the seller's retirees, their spouses and dependents with health coverage following a corporate transaction, and (2) in such cases, criteria that should apply to the replacement coverage in determining whether to treat those individuals as "not having lost coverage." The proposed regulations provide a special rule addressing cases in which an employer adopts plan terms that establish eligibility for health coverage for some individuals, but provide that those same individuals lose health coverage upon the occurrence of a particular event or after a stated period of time. In those cases, an individual would not be counted as having lost health coverage by reason of employer action merely because that individual's coverage ends upon the occurrence of the event or after the stated period of time. The regulations are proposed to be applicable to transfers of excess pension assets on or after December 18, 1999. Thomas T. Kim Assistant Counsel Attachment Attachment (in .pdf format)