

# Employee Benefit Plan Review

OCTOBER 2008

## Section 415 Amendments Require Careful Consideration

Section 415 of the Internal Revenue Code sets forth limitations on benefits that may be provided under tax-qualified defined contribution and defined benefit plans and Code Section 403(b) annuity contracts. Final regulations on Section 415 published in April 2007 contain extensive guidance on applying the limitations to plan benefits. The regulations apply to limitation years beginning on or

after July 1, 2007 (January 1, 2008, for calendar year plans). Plans must be amended to comply with the final regulations in accordance with the remedial amendment period rules. Calendar year plans of calendar year taxpayers must be amended by the employer's tax return due date (including extensions) for 2008.

All tax-qualified and 403(b) plans are required to implement the final regulations. Failure to do so is grounds for

**EXHIBIT 1. AMENDMENTS REQUIRED BY SECTION 415**

Type of Plan	Plan Provision	Required or Optional	Default Provision
All Types	Set forth the Section 415 limits or incorporate by reference.	Required	N/A
Defined Benefit	Preclude the possibility that annual benefit exceeding Section 415 limits will be accrued, distributed, or otherwise payable in any form of benefit at any time.	Required	N/A
Defined Benefit	If employer has two defined benefit plans, specify how benefits will be limited to prevent violation of Section 415(b) without employer discretion.	Required	N/A
Defined Contribution	Preclude the possibility that annual additions will exceed Section 415 limits.	Required	N/A
Defined Contribution	If employer has two profit-sharing or stock bonus plans, specify under which plan allocations will be reduced to prevent violation of Section 415(c) and how reduction will occur without employer discretion.	Required	N/A
All Types	Amend the Section 415 limits to adopt annual cost-of-living adjustments or incorporate by reference.	Optional	Cost-of-living adjustments do not apply.
All Types	Provide a limitation year of any 12-month period.	Optional	Limitation year is calendar year.
All Types	Amounts received pursuant to a nonqualified unfunded deferred compensation plan are considered compensation for Section 415 purposes in the year actually received.	Optional	Amounts received pursuant to a nonqualified unfunded deferred compensation plan are not includible in Section 415 compensation.

**EXHIBIT 1. CONTINUED**

Type of Plan	Plan Provision	Required or Optional	Default Provision
All Types	Compensation for Section 415 purposes includes only items specified in Regulations § 1.415(c)-2(b)(1) or (2) and excludes all items listed in § 1.415(c)-2(c) (safe harbor 1).	Optional	Section 415 compensation includes all items described in § 1.415(c)-2(b) and excludes all items listed in §1.415(c)(2)(c).
All Types	Compensation for Section 415 purposes includes wages within the meaning of Section 3401(a) plus amounts that would be included in wages but for an election under Sections 125(a), 132(f)(4), 402(e)(3), 402(h)(1)(B), 401(k), or 457(b) (safe harbor 2).	Optional	Same default provision as for safe harbor 1.
All Types	Compensation for Section 415 purposes includes the amounts in safe harbor 2 plus all other compensation from the employer for which the employer is required to furnish a written statement under Sections 6041(d), 6051(a)(3), or 6052 (safe harbor 3).	Optional	Same default provision as for safe harbor 1.
All Types	Compensation for Section 415 purposes includes amounts earned during the limitation year but paid during the first few weeks of the next year solely due to timing of pay periods and pay dates if included on a uniform and consistent basis for all similarly situated employees.	Optional	Compensation for a limitation year includes only amounts paid during that year.
All Types	Compensation for Section 415 purposes includes (1) payment for unused sick or vacation time paid after severance from employment and/or (2) amounts received after severance from employment under a nonqualified unfunded deferred compensation plan that would have been paid if the employee had continued in employment, if paid by 2 1/2 months after severance or the end of the limitation year, if later, and if such amounts would have been included in compensation if paid prior to severance.	Optional	No amounts paid after severance are included in Section 415 compensation except regular pay paid by 2 1/2 months after severance or the end of the limitation year, if later.
All Types	Compensation for Section 415 purposes includes differential pay paid to individuals in qualified military service. <b>NOTE:</b> Pursuant to the Heroes Earnings Assistance and Relief Act of 2008, effective January 1, 2009, differential pay paid to individuals in qualified military service is required to be included in compensation.	Optional prior to 1/01/09 Required effective 1/01/09	No amounts paid after severance are included in Section 415 compensation except regular pay paid 2 1/2 months after severance or the end of the limitation year, if later.
All Types	Compensation for Section 415 purposes includes compensation paid to a participant who is permanently and totally disabled if the participant is not highly compensated or compensation is continued for a determinable period for all disabled participants.	Optional	No amounts paid after severance are included in Section 415 compensation except regular pay paid 2 1/2 months after severance or the end of the limitation year, if later.
Defined Benefit	Rate of benefit accrual is automatically frozen or reduced to a level necessary to prevent Section 415 limits from being exceeded.	Optional	Benefit accruals are not automatically frozen or reduced.
Defined Benefit	The annual cost-of-living adjustments to the dollar limit and/or the compensation-based limit apply after a participant's severance from employment.	Optional	Cost-of-living adjustments do not apply after severance.
Defined Benefit	Plan may specify any 12-month period to determine year of service in applying the compensation-based limit if uniformly and consistently applied.	Optional	12-month period to determine year of service in applying the compensation based limit is calendar year.

**EXHIBIT 1. CONTINUED**

Type of Plan	Plan Provision	Required or Optional	Default Provision
Defined Benefit	A plan that includes an automatic benefit increase is not required to adjust a benefit paid in a form other than a straight-life annuity to take into account the increase if the benefit is paid in a form other than a qualified joint and survivor annuity and the amount payable to the participant in any limitation year cannot exceed the Section 415(b) limit on the annuity starting date, increased for cost-of-living in subsequent years.	Optional	A plan that includes an automatic benefit increase must adjust to take into account the increase.
Defined Benefit	For purposes of determining the adjustment to the dollar limit for distributions with annuity starting dates before age 62, if benefits are not forfeited upon death before annuity starting date, the plan may adjust to reflect the probability of the participant's death between the annuity starting date and age 62.	Optional	No adjustment is made to reflect the probability of the participant's death between annuity starting date and age 62.
Defined Benefit	For purposes of determining the adjustment to the dollar limit for distributions with annuity starting dates before age 62 or after age 65, if the plan does not charge for providing a pre-retirement survivor annuity (QPSA), the plan is permitted to treat benefits as not forfeited upon death, and provide that no adjustment is made to reflect the probability of the participant's death between the annuity starting date and age 62, or between age 65 and the annuity starting date.	Optional	If the plan does not charge for providing a QPSA, but a forfeiture occurs upon a participant's death before annuity starting date, an adjustment must be made to reflect the probability of the participant's death between the annuity starting date and age 62, or between age 65 and annuity starting date.
Defined Benefit	For purposes of determining the reduction to the compensation and benefits limits for service of less than 10 years, a participant who is permanently and totally disabled for an accrual computation period may be credited with service with respect to that period.	Optional	A participant is credited with service for an accrual computation period only if he is credited with service sufficient to accrue a benefit for that period.
Defined Contribution	Compensation for Section 415 purposes includes the deemed compensation of a participant who is permanently and totally disabled, determined as compensation the participant would have received if paid at the rate paid immediately before becoming disabled, if the participant is not highly compensated or contributions are continued for a determinable period for all disabled participants and are nonforfeitable when made.	Optional	No amounts paid after severance are included in Section 415 compensation except regular pay paid by 2 1/2 months after severance or the end of the limitation year, if later. But see optional provision above for compensation paid to disabled participants.
Employee Stock Ownership Plan	An ESOP with an exempt loan may provide that annual additions with respect to the loan repayment are determined as the fair market value of shares released from the suspense account and allocated to participant accounts, if less than the principal and interest.	Optional	Annual additions with respect to the loan re-payment are the principal and interest used to repay the loan for the limitation year.

disqualification of the plan. A plan may incorporate most of the Section 415 rules by reference. Plans that incorporate the rules by reference are deemed to adopt numerous "default" provisions set forth in the regulations. The regulations also contain

optional provisions that provide an alternative to the default provisions. These optional provisions are available to plans that incorporate the rules by reference only by adopting amendments that specifically apply the optional provisions. There are

also certain provisions required by the regulations that must be set forth in plan documents and cannot be incorporated by reference.

All sponsors of tax-qualified and 403(b) plans and their advisors should become familiar with

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the required and optional amendments provided under Section 415. Careful consideration of the default provisions, and the alternatives available, is required to prepare the appropriate plan amendments by the deadline. For convenience, calendar year plan sponsors may want to consider adopting Section 415 amendments by December 31, 2008, in connection with other year-end amendments. For example,

calendar year defined benefit plans are required (by the Pension Fund Equity Act of 2004) to be amended by December 31, 2008, to reflect the 5.5 percent interest rate assumption required under Code Section 415(b)(2) for distributions beginning in 2004 and 2005.

The accompanying chart summarizes the amendments required by Section 415, the optional amendments that

are available, and the default provisions that apply. ☺

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