

IRS PROVIDES GUIDANCE REGARDING CASH BALANCE PLANS AND DEFINITELY DETERMINABLE BENEFIT FORMULAS

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The IRS has issued a memorandum to reviewers of determination letter requests for cash balance plans for and agents conducting audits of cash balance plans where the plan has not received a determination letter. The guidance deals with the issue of whether the cash balance plan formula meets the requirements of Treasury Reg. Section 1.41-1(b)(1)(i) which requires that a plan contain a definitely determinable benefit. The guidance is directed to cash balance plans where the compensation credit under the cash balance plan is not based on total annual compensation. For example, in situations where the pay credit is based on compensation for a particular month or is limited to certain compensation such as special bonuses or compensation in excess of a certain dollar threshold. The guidance finds that a formula that is based on partial compensation will be definitely determinable even if the employer has the inherent ability to determine that employee's compensation outside of the terms of the plan. In other words, if the terms of the plan provide a formula by which the pay credit can be determined by looking at compensation information otherwise available, it is definitely determinable. If the plan terms give employer discretion to determine what compensation is, then the plan formula does not meet the requirement. In an example the IRS describes a formula that provides that the pay credit will be based on the compensation paid in the month of March will not meet the requirement if the employer can determine what constitutes "compensation" that is paid in the month of March. However, if the employer indicated that the formula was W-2 compensation paid in March, then it would be definitely determinable because the W-2 definition does not give the employer discretion. This is the case even though the employer would have the discretionary ability through the manner in which it pays compensation to either increase or decrease W-2 compensation payable within March.

Employers that maintain cash balance plans where the pay credit is determined on only a portion of compensation should review with their legal advisors whether the terms of the plan meet the definitely determinable requirement as described in the guidance. TE/GE Memorandum 04-0417-0014