



THE REPEAL OF THE COMBINED PLAN LIMIT - AN OPPORTUNITY OR A HEADACHE?

Starting next year, retirement benefits for individuals who participate in both a defined benefit pension plan and a defined contribution retirement plan sponsored by the same employer could increase because of a 1996 law change. That's great news for certain employers who want to maximize retirement benefits for their highly paid plan participants. It's not such great news for other employers who may face an unexpected, additional benefit burden.

The Background Story

For a number of years, the tax law (Section 415(e)) has required employers with both a defined benefit pension plan and a defined contribution plan to use a special formula in determining benefits and contributions for employees who participate in both plans. The effect has been to limit tax-favored benefits for highly paid employees.

The Small Business Job Protection Act of 1996 (SBJPA) repealed the combined plan limit. However, the repeal generally does not go into effect until January 1, 2000. (Technically, the repeal is effective for "limitation years" beginning after 1999.) As a result of the law change, participants will be able to receive the maximum benefit under a defined benefit plan and the maximum contribution under a defined contribution plan at the same time.

Highly paid professionals and company owners will likely welcome this change. Their firms may be able to contribute more and provide larger benefits for them. However, other employers will face an increased benefit liability they don't want. These sponsors may be able to amend their plans prior to January 1 to prevent automatic benefit increases from taking effect.

Review Your Plan

Plan sponsors with combined plans should review the specific provisions of their plans to determine how the law change will affect them. Employers who do **not** want benefits to increase automatically may have to amend their plans. For example, plans that incorporate the Section 415 limitations by reference may be subject to automatic increases unless amended.

Buying Additional Time

The law makes it very difficult to take benefits away from employees. Anti-cutback rules generally forbid amending a qualified retirement plan to eliminate or reduce a benefit that a participant has already earned. Amending a plan now to prevent an automatic benefit increase may make sense for employers who need more time to evaluate their situations. This strategy will buy additional time to analyze the long-term effects of the law change. A subsequent amendment to take the increase into account at a later date generally would be permissible.

Questions

The repeal of the combined plan limit forces employers to answer several questions. Do we amend or not? How do we determine the maximum allowable benefits? How much are we willing to contribute to the plan?

If you sponsor both a defined benefit and defined contribution plan, you will have to weigh your options carefully. We can help you with that analysis. Please give us a call us soon.