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## Client Alert

### Section 204(h) Notice Not Required in 2007 for Certain Pension Protection Act Amendments

by Lynne A. Lacoursière

**On Nov. 6, 2007, the Internal Revenue Service announced that proposed regulations to be issued under Section 4980F of the Internal Revenue Code of 1986 (the Code), and Section 204(h) of the Employee Retirement Income Security Act of 1974 (ERISA), will address the advance notice requirements for certain required amendments under the Pension Protection Act of 2006 (the PPA).**

The IRS said the proposed regulations will provide that a reduced single-sum benefit under a traditional defined benefit plan resulting from an amendment to substitute the PPA-prescribed interest rate and mortality table actuarial assumptions under Code Section 417(e)(3) will not require a Section 204(h) notice. Also, the proposed regulations will provide that notice of funding-based limitations on certain forms of distribution required under ERISA Section 101(j) for amendments restricting benefits in accordance with Code Section 436 will also satisfy both the timing and content requirements for a Section 204(h) notice.

Prior to the IRS announcement, there had been some uncertainty as to whether sponsors of defined benefit pension plans needed to distribute Section 204(h) notices to participants in connection with the PPA's mandatory change in actuarial assumptions for minimum lump sum calculations under Code Section 417(e)(3), which takes effect on January 1, 2008. Section 204(h) notices are required if a plan amendment may result in a significant reduction in either the rate of future benefit accruals or an early retirement benefit or retirement-type subsidy. Because the PPA change in actuarial assumptions could result in reduced lump sums for some participants, there was concern that such a change would trigger the Section 204(h) notice requirement. In general, the 204(h) notice must be given 45 days before the effective date of the amendment. Thus, if Section 204(h) notices were required, the deadline for distribution would have been Nov. 15, 2007. After the IRS announcement, however, it is now clear a Section 204(h) notice is not needed in this instance, at least with respect to "traditional" defined benefit plans where the PPA-prescribed actuarial assumptions are substituted for pre-PPA actuarial assumptions under Section 417(e)(3).

Some traditional defined benefit plans currently provide for the use of either plan assumptions or the pre-PPA actuarial assumptions under Section 417(e)(3), whichever would provide a larger lump sum amount. If the plan sponsor now desires to eliminate this “greater of” approach, a 204(h) notice may be required.

The recent IRS guidance leaves open the possibility that plan sponsors of “nontraditional” defined benefit plans, such as cash balance plans, may still need to distribute Section 204(h) notices by Nov. 15. One reason for this is that the PPA permits sponsors of cash balance plans to eliminate “whipsaw” calculations that can result in a higher lump sum distribution under Section 417(e) than a participant’s hypothetical account balance. Because plan amendments eliminating whipsaw calculations could result in reduced lump sum benefits, last December the IRS issued Notice 2007-6, which states that a 204(h) notice is required if a cash balance plan is amended to eliminate whipsaw calculations of lump sum distributions.

For cash balance plans that are not eliminating whipsaw calculations, but otherwise provide lump sum distributions or other forms of benefit (such as level income annuities) that may be affected by the switch to PPA-prescribed actuarial assumptions, the IRS’s recent guidance supports the view that a Section 204(h) notice should not be required simply because of such switch. However, because the IRS limited the scope of its recent guidance to “traditional defined benefit plans,” cash balance plan sponsors will have to wait until the proposed regulations are issued before they will have a definitive answer. Unfortunately, if the proposed regulations require a Section 204(h) notice in cases where the cash balance plan is not eliminating the whipsaw effect, it will then be too late to provide the notice.

Sponsors of traditional defined benefit plans should review their provisions for the determination of lump sum equivalents, including the provisions for small lump payouts. Where the plan currently requires the use of the “greater of” plan assumptions or pre-PPA actuarial assumptions, the new PPA actuarial assumptions under Section 417(e)(3) may be substituted in the “better of” formula without a 204(h) notice. However, if the plan sponsor wants to eliminate the use of plan assumptions in the formula, a 204(h) notice may be required.

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For further information, please contact:

### New York

Susan P. Serota [\(bio\)](#)

+1.212.858.1125

[susan.serota@pillsburylaw.com](mailto:susan.serota@pillsburylaw.com)

Peter J. Hunt [\(bio\)](#)

+1.212.858.1139

[peter.hunt@pillsburylaw.com](mailto:peter.hunt@pillsburylaw.com)

John J. Battaglia [\(bio\)](#)

+1.212.858.1738

[john.battaglia@pillsburylaw.com](mailto:john.battaglia@pillsburylaw.com)

Mark C. Jones [\(bio\)](#)

+1.212.858.1738

[mark.jones@pillsburylaw.com](mailto:mark.jones@pillsburylaw.com)

Lynne A. Lacoursière [\(bio\)](#)

+1.212.858.1543

[lynne.lacoursiere@pillsburylaw.com](mailto:lynne.lacoursiere@pillsburylaw.com)

### Northern Virginia

Howard L. Clemons [\(bio\)](#)

+1.703.770.7997

[howard.clemons@pillsburylaw.com](mailto:howard.clemons@pillsburylaw.com)

Keith R. Kost [\(bio\)](#)

+1.703.770.7799

[keith.kost@pillsburylaw.com](mailto:keith.kost@pillsburylaw.com)

**San Diego – North County**

Jan H. Webster **(bio)**  
+1.858.509.4012  
jan.webster@pillsburylaw.com

Lori Partrick **(bio)**  
+1.858.509.4087  
lori.partrick@pillsburylaw.com

**San Francisco**

Christine L. Richardson **(bio)**  
+1.415.983.1826  
crichardson@pillsburylaw.com

**Silicon Valley**

Cindy V. Schlaefter **(bio)**  
+1.650.233.4023  
cindy.schlaefter@pillsburylaw.com

**Washington, DC**

Kurt L. P. Lawson **(bio)**  
+1.202.663.8152  
kurt.lawson@pillsburylaw.com

Daniel N. Riesenber **(bio)**  
+1.858.847.4130  
daniel.riesenberg@pillsburylaw.com

Kenneth E. Bonus **(bio)**  
+1.858.847.4206  
kenneth.bonus@pillsburylaw.com

Jennifer Dack Brooks **(bio)**  
+1.415.983.1547  
jennifer.brooks@pillsburylaw.com

Julie Yoon **(bio)**  
+1.650.233.4068  
julie.yoon@pillsburylaw.com

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