IRS Notice 2007-28: Clarification on Deduction Limits For Combination DB/DC Plans

The Pension Protection Act of 2006 (PPA) provided changes to the rules governing the deduction limits for certain qualified plan arrangements under IRC §404(a)(7) where the plan sponsor makes contributions to both a defined benefit and defined contribution for the same group of participants in a particular year. Since the enactment of PPA, there has been considerable debate on the interpretation of these rules among pension practitioners and regulators and this has led to a number of issues. In response to this ongoing debate, the IRS released Notice 2007-28 (www.irs.gov/pub/irs-drop/n-07-28.pdf).

Prior to the enactment of PPA, IRC §404(a)(7) provided that in the event of contributions to a combination of one or more DC plans and one or more DB plans, the total amount deductible in a taxable year under such plans could not exceed the greater of:

• 25% of the compensation paid or accrued during the taxable year to the beneficiaries under such plans, or

• The amount of contributions made to or under the DB plans to the extent that such contributions do not exceed the amount necessary to satisfy the minimum funding standard provided by IRC §412 with respect to any such DB plan for the plan year that ends with or within such taxable year.

PPA §803 amended IRC §404(a)(7) to apply the combined plan limits only in the case of employer contributions to one or more DC plans to the extent that such contributions exceed 6% of the compensation otherwise paid or accrued during the taxable year to the beneficiaries under the plan.

Pension practitioners assumed that with the "6% cushion" enacted by PPA, plan sponsors could fund DC matching and nonelective contributions up to 6% of aggregate compensation of the DC plan participants without triggering the IRC §404(a)(7) limit. If employer contributions to the DC plan exceeded 6%, it was generally assumed that only the DC contribution in excess of 6% would be counted toward the combined limit. Some practitioners though were concerned that if the DC contributions exceeded the 6%, the IRS would interpret the law to include all DC contributions in the 25% limit, including those in excess of 6%. This would effectively mean that a DC contribution of "one penny more" would eliminate the ability to deduct not only the penny but the entire 6% which would have been otherwise deductible had the extra penny not been contributed.

Q&A-8 clarifies that the "all or nothing, based on just one penny more" interpretation does not apply to situations where employer contributions to DC plans exceed 6% of the applicable compensation. The general rule of IRC §404(a)(7) for determining the maximum amount deductible remains the same, but the employer contributions to which the rule applies are equal to the employer contributions in excess of 6% of applicable participant's compensation in the DC plan.

The complete text of the notice can be found at www.irs.gov/pub/irs-drop/n-07-28.pdf