What is the PBGC & Does it Cover our Cash Balance Plan?

Facts

Our company is thinking of setting up a cash balance plan. In our research about what that entails, we keep running into information about the PBGC and paying premiums.

Question

What is the PBGC and how do we know if our plan would be covered?

Answer

The first part of your question is pretty straight-forward, but the second part is a little more involved.

What is the PBGC?

PBGC stands for the Pension Benefit Guaranty Corporation, and it is a quasi-governmental agency created by Congress (as part of ERISA in 1974). Its purpose is to protect participant benefits in defined benefit plans that terminate without enough assets to cover those benefits. The PBGC accomplishes this by collecting premium payments from companies that sponsor covered plans. Think of it as being similar to an insurance company that collects premiums in return for protections against other types of losses.

Which Plans Are Covered?

Probably the easiest way to answer this question is to say that all non-governmental defined benefit plans are covered by the PBGC unless they qualify for one of the following exceptions:

- Plans sponsored by small, professional services firms,
- Plans covering only substantial owners,
- Certain plans that cover only Puerto-Rico residents; or
- Certain church plans.

Defined contribution plans, such as 401(k) plans, are never subject to PBGC coverage.

Small, Professional Service Plans

Defined benefit plans sponsored by professional services firms that have never covered more than 25 active participants at any time since ERISA's enactment in September 1974 are exempt from PBGC coverage. That begs the question of what, exactly, is a professional services firm.

ERISA defines a professional services business as a company owned by professional individuals, and the term "professional individuals" includes (but is not limited to) physicians, dentists, chiropractors, osteopaths, optometrists, other licensed practitioners of the healing arts, attorneys at law, public accountants, public engineers, architects, draftsmen, actuaries, psychologists, social or physical scientists, and performing artists. Note that investment advisor is not listed as a professional individual; however, remember that this list was put together more than four decades ago. Some recent determinations from the PBGC have included plans sponsored by investment professionals as covered plans.

PBGC coverage kicks in as soon as the plan covers its 26th active participant, and the plan remains covered indefinitely, even if the active participant count later drops below that threshold.

Substantial Owner Plans

Plans that cover only substantial owners of the company sponsoring the plan are also exempt from PBGC coverage. A participant is a "substantial owner" if he or she meets either of the following at any point in the trailing five-year period:

- For unincorporated entities such as sole proprietorships, he or she owns 100%, or
- For a partnership or corporation, he or she owns more than 10%.

It is important to note that the family attribution rules that apply in determining whether companies are related as part of a controlled group also generally apply in establishing these ownership percentages. However, there are some exceptions. For example, once a child of a substantial owner reaches age 26, his/her participation in the plan could trigger PBGC coverage. With respect to spouses, it is quite possible that if the company is in a non-community property state, a spouse's participation in the plan could trigger PBGC coverage.

As soon as a substantial owner plan covers its first non-owner participant, it immediately becomes covered by the PBGC. However, if a covered plan later becomes a plan with only substantial owners, the sponsor can request to no longer be covered.

Puerto Rico Plans

Since Puerto Rico has its own tax code, plans that cover only Puerto Rico residents are generally not required to meet all of the "qualification" rules that apply to other plans, including coverage by the PBGC, as long as the plan's trust was established in Puerto Rico.

These types of plans can voluntarily elect to be treated the same as mainland qualified plans, and if they make that election, they are then subject to PBGC coverage.

Church Plans

Plans that are established and maintained by churches are exempt from PBGC coverage. Similar to Puerto Rico plans, churches can make an election to be covered.

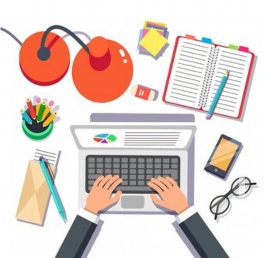
Still Not Sure?

So, what do you do if, say, you aren't sure whether the company's owners are considered professional individuals? Ask the PBGC. They will review the facts and circumstances of your situation and make a determination for you. Their website notes that requests should be accompanied by "sufficient information to enable PBGC to make a determination" and provides a few bullet points of examples for each exemption category.

In the meantime, if you are not sure whether your plan is covered, assume that it is until you hear otherwise from the PBGC. Of course, you can always call your good friends here at DWC and we can help you talk through the details.

Related Resources

- Cash Balance Plans: A Closer Look
- Are There Risks to Contributing More Than the Minimum to a Cash Balance Plan?



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