Stepnowski v. Commissioner, 123 T. C. 111 (U. S. Tax Court 2004)

In Stepnowski v. Commissioner, the U. S. Tax Court upheld the IRS's determination that Hercules Incorporated's pension plan amendment, changing the interest rate used to calculate lump-sum payments from the PBGC rate to the 30-year Treasury bond rate, complied with the anti-cutback rule of Section 411(d)(6). The court's decision affirmed that the amendment fell within a regulatory safe harbor, allowing for such changes without violating the accrued benefit protections, setting a precedent on the scope of permissible plan amendments under ERISA.

Parties

Charles P. Stepnowski, the Petitioner, challenged the determination of the Respondent, the Commissioner of Internal Revenue. Hercules Incorporated was joined as a Respondent in the proceedings.

Facts

Hercules Incorporated maintained a defined benefit pension plan established in 1913, which allowed participants to elect a lump-sum payment option. In 2001, Hercules amended its plan to change the interest rate used for calculating the lump-sum payment from the PBGC rate to the annual interest rate on 30-year Treasury securities, effective January 1, 2001. The amendment also provided that for payments made on or after January 1, 2000, but before January 1, 2002, participants would receive the greater of the amount calculated under the old or new interest rate assumptions. On February 15, 2002, Hercules sought a determination from the IRS that the amended plan met the qualification requirements of Section 401(a), which the IRS granted on March 3, 2003. Charles P. Stepnowski, an interested party, challenged this determination, asserting that the amendment violated the anti-cutback rule of Section 411(d)(6).

Procedural History

Stepnowski filed a petition for declaratory judgment under Section 7476(a) in the U. S. Tax Court. Hercules was joined as a party-respondent. The court denied Stepnowski's motions for discovery and to calendar the case for trial, relying on the administrative record. The court's decision was based on the legal issue of whether the amendment constituted an impermissible "cutback" under Section 411(d)(6).

Issue(s)

Whether the amendment to Hercules Incorporated's pension plan, which changed the interest rate used to calculate the lump-sum payment option from the PBGC rate to the 30-year Treasury bond rate, violated the anti-cutback rule of Section 411(d)(6).

Rule(s) of Law

Section 411(d)(6) of the Internal Revenue Code prohibits plan amendments that decrease a participant's accrued benefit. However, under Section 1. 417(e)-1(d)(10)(iv) of the Income Tax Regulations, a plan amendment that changes the interest rate used for calculating the present value of a participant's benefit is not considered to violate Section 411(d)(6) if it falls within certain safe harbors. Specifically, the amendment must replace the PBGC interest rate with the annual interest rate on 30-year Treasury securities, and the new interest rate must be no less than that calculated using the applicable mortality table and the applicable interest rate.

Holding

The U. S. Tax Court held that the amendment to Hercules Incorporated's pension plan did not violate the anti-cutback rule of Section 411(d)(6) because it complied with the safe harbor provided by Section 1. 417(e)-1(d)(10)(iv) of the Income Tax Regulations.

Reasoning

The court's reasoning centered on the interpretation of the applicable regulations and revenue procedures. It noted that the amendment replaced the PBGC interest rate with the 30-year Treasury bond rate, which was permissible under the safe harbor. The court rejected Stepnowski's argument that the amendment was untimely under Section 1. 417(e)-1(d)(10)(i), as that section's deadline applied only to amendments affecting certain annuity forms of distribution, not lump-sum payments. The court also considered the series of revenue procedures that extended the remedial amendment period for adopting such plan amendments until February 28, 2002, and found that Hercules complied with these deadlines. Furthermore, the court addressed the additional requirement established by Rev. Proc. 99-23, ensuring that the amendment provided the greater of the two interest rates for payments made between January 1, 2000, and January 1, 2002. The court concluded that the IRS correctly applied the law in issuing a favorable determination letter to Hercules.

Disposition

The court entered a decision for the respondents, affirming the IRS's favorable determination letter regarding the qualification of Hercules Incorporated's amended pension plan.

Significance/Impact

Stepnowski v. Commissioner is significant for its clarification of the scope of permissible amendments to defined benefit plans under ERISA and the Internal Revenue Code. The decision reinforces the applicability of regulatory safe harbors that allow plan sponsors to adjust interest rate assumptions without running afoul of the anti-cutback rule. This ruling has practical implications for plan sponsors seeking to amend their plans to reflect changes in applicable interest rates, ensuring compliance with regulatory requirements while maintaining plan qualification. Subsequent courts have referenced this decision in addressing similar issues of plan amendments and the anti-cutback rule, highlighting its doctrinal importance in the field of employee benefits law.

