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PERSPECTIVES

Fundamentals of Internal Revenue Code Section 415(b)

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What is IRC Section 415(b)?

Final regulations governing Internal Revenue Code (IRC) Section 415(b) were issued on April 4, 2007. Code §415(b) places limits on amounts that may be paid from defined benefit (DB) retirement plans that are "qualified" under Code §401(a).

What is the basic §415(b) limit and how does it apply to defined benefit plans?

In 2020, the benefit limit for DB plans is $230,000. Unfortunately, compliance with §415(b) and the associated regulations is not as simple as limiting all retirement benefits from a DB plan to $230,000 per year. In fact, there are cases where §415(b) permits benefits to exceed that amount, and other cases where §415(b) might only permit a fraction of that amount to be paid.

The basic §415(b) dollar limits are adjusted annually in a manner that is similar to the method used to adjust Social Security benefits. When they occur, annual adjustments to the §415(b) limit are made in $5,000 increments.

Given the magnitude of these limits, why should plan administrators bother with §415(b)?

The basic IRC §415(b) limit is a fairly large number. It may be surprising, but in any plan, there can be individuals whose benefits come close to or exceed the limits. If the benefit of even one person exceeds the limits, the plan would be out of compliance with §415(b).

Compliance with §415 is a *plan qualification* issue and, therefore, the IRS could disqualify a non-compliant plan. In the case of disqualification, investment income to the trust would become taxable, and plan participants would be taxed on contributions to the trust *as they are made* (as opposed to when they are distributed in the form of retirement benefits) – a severe penalty indeed. So far, the author is not aware of this extreme penalty having been imposed on a governmental plan.

What are the differences in applying §415(b) regulations to ERISA plans versus governmental and non-electing church plans?

There are significant differences in the application of §415(b) and the associated regulations between "ERISA plans" and "other plans." In this context, the term "ERISA plan" means a plan that is subject to the vesting rules in IRC §411. The term "other plans" consists of governmental plans within the meaning of IRC §414(d) and of those church plans that have elected not to be covered under the participation, vesting, and funding requirements of Title II of ERISA. Such church plans are called "non-electing" church plans and, for obvious reasons, most church plans are non-electing. (Note: This *GRS Perspectives* does not discuss issues related to multiemployer plans).

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The key differences in application of the regulations between ERISA plans, and governmental and non-electing church plans are summarized below:

KEY DIFFERENCES IN THE APPLICATION OF IRC SECTION 415(b) FOR ERISA PLANS VERSUS GOVERNMENTAL/NON-ELECTING CHURCH PLANS
ERISA plans must limit the benefit paid to 100% of three-year highest average compensation; whereas, governmental plans do not have a percent of pay limit. In addition, there is no percent of pay limit for certain non-electing church plans except with respect to benefits earned during a period in which the individual is a highly compensated employee under 414(q).[1]
ERISA plans must limit the accrued benefit; whereas, governmental and non-electing church plans must only limit the benefit actually paid.[2]
As a general rule, benefits are adjusted (reduced) for commencement ages prior to age 62. In governmental plans, there is no reduction for public safety employees or members of the U.S. Armed Forces with at least 15 years of "qualifying" service. There is also no age adjustment for pre-retirement death and disability benefits in governmental plans.

It should be noted that virtually all private-sector employees, and in particular those participants in ERISA plans, are covered by Social Security. By comparison, only about 75% of governmental employees are covered by Social Security. *However, no distinction is made in the application of §415(b) limits based upon the presence or absence of Social Security coverage.*

How are §415(b) regulations applied to governmental plans and non-electing (i.e., most) church plans?

The remainder of this issue of *GRS Perspectives* focuses on the application of the §415(b) regulations to governmental plans and to non-electing (i.e., most) church plans.

Testing for compliance with §415(b) can be quite challenging. The regulations covering §415(b) are extensive and complex. Although the 2007 regulations eliminated many ambiguities and previously unaddressed issues in application of the limits, they are not completely definitive. In some cases, correct application of the §415(b) regulations will depend on how a particular pension plan document is written. In other cases, there are multiple ways to interpret the regulatory language or to apply a principle and the plan administrator must determine which interpretation will be applied. The final interpretation should ideally be included in the plan document or, otherwise, recorded in a manner that ensures consistent treatment of individuals. The plan administrator should make this determination based upon discussion with legal counsel and perhaps other professionals.

The following paragraphs outline the main concepts of §415(b) and the associated regulations.

The §415(b) limit applies to benefits paid in the "limitation year." The limitation year defaults to the calendar year, but can be defined differently in the plan document. Using a non-calendar limitation year complicates the testing process and should be selected only after a careful review of legal and administrative issues. If the limitation year is the calendar year, the amount of the limit is known at the start of the year and can readily be applied. Otherwise, both the calendar year limit and the limitation year limit must be separately applied. In the case of non-calendar limitation years, the ultimate limit is the limit that becomes effective for the calendar year that begins in the limitation year.

[1] Code §415(b)(11).
[2] Treas. Reg. §1.415(b)-1(a)(7)(iii).

Therefore, the ultimate limit is usually unknown at the beginning of the limitation year.

For instance, if the limitation year is April 1 through March 31, and a member retires on April 1, 2020, the annual §415(b) limit would be based on the limit in effect for the 2021 calendar year (i.e., the calendar year limit that begins in the limitation year), which would not be known until the last quarter of 2020. In addition, although there is no precise IRS guidance on the matter, most practitioners believe that the limit in effect for the calendar year in which the limitation year begins remains in effect for the plan until the last day of the calendar year. This means that benefits paid in the fractional part of the limitation year ending on December 31 cannot exceed the (preceding) calendar year limitation amount (calendar year 2020 in the above example). Thus, for non-calendar limitation years, two separate calendar year limits must be tracked.

For example:

- A plan has a limitation year that begins on April 1 and a member retires on April 1, 2020 with an annual benefit (i.e., before application of §415) of $204,000 (or $17,000 per month).
- Suppose the §415(b) limit adjusted for age and all other applicable factors for this individual for the 2020 calendar year is $100,000. This means that the member's total payments allowed from the plan from April 1, 2020 to December 31, 2020 are limited to $100,000 instead of the $153,000 (i.e., $17,000 x 9) that would otherwise have been paid from the plan if the §415(b) limit had not applied.
- If the limit for the full limitation year (i.e., April 1, 2020 through March 31, 2021) is $105,000 (which is based on the §415(b) limit in effect for calendar year 2021: the calendar year that begins during the limitation year), the plan could only pay the member $5,000 from January 1, 2021 to April 30, 2021.
- Any benefits in excess of the amounts limited by §415(b) would need to be paid to the member from the employer's excess benefit plan, if applicable (i.e., $204,000 - $105,000 = $99,000).

The limit applies to a benefit paid in the straight life form. The effective limit is adjusted to the extent that the benefit being paid is not a straight life benefit. The actual benefit being paid may involve a joint and survivor type benefit, a period certain, a benefit that reduces at Social Security age, a partial (or even full) lump sum amount, a cash refund annuity of some type, a significant death after retirement benefit, or a distribution from a Deferred Retirement Option Plan (DROP). Such benefits must be converted to the equivalent straight life form for comparison with the §415(b) limit. The regulations describing the conversion of the benefit being paid into the straight life form and the associated adjustment to the effective limit are complicated and depend on the specifics of the benefit itself. It is not just a matter of using the plan's straight life form for the calculation.

- In some cases (benefits addressed in §417(e)(3) even where §417(e)(3) does not apply to the plan) which include lump sum benefits, significant death after retirement benefits, and generally benefits payable over a period shorter than the retiree's lifetime, three different calculations must be made: (1) the first calculation involves the plan factors, if there are any; (2) the second calculation is based upon 5.5% interest and the applicable mortality table specified by the IRS, which the IRS updates annually; and (3) the third calculation involves "minimum present value segment rates" defined in connection with §417(e)(3)(D) and the applicable mortality table. There is also a division by 1.05 in this third calculation. *The calculation that produces the lowest effective limit is then chosen.*
- In other cases (benefits not addressed in §417(e)(3) which would include most routine types of benefits), two calculations are made: (1) the first calculation involves plan factors, if there are any; and (2) the second calculation involves 5% interest and the applicable mortality table. *The calculation that produces the lesser effective limit is then chosen.*

Qualified Joint and Survivor Annuity (QJSA) options

(i.e., joint and survivor options from 50% to 100% in favor of a spouse) can normally be ignored in the calculations. However, if the QJSA includes a certain period, or some other non-QJSA benefit, the value of the non-QJSA portion of the benefit must be calculated and converted to the straight life form. Doing so will reduce the effective limit from what it would have been otherwise. Some practitioners think that the "pop-up" portion (if any) of a QJSA benefit payment should not be treated in this manner. In the case of a pop-up, such treatment would further complicate an already complicated process, particularly if the beneficiary dies prior to the retiree.

The limit applies to the employer-provided benefit. This rule means that employee contributions, if any, may act to increase the effective §415(b) limit. While this sounds simple, it actually can be rather complicated. Many governmental plans require employee contributions, and not all employee contributions are created equal. IRC §414(h) "pick-up" contributions, although made by the employee, are treated as employer contributions. Loan repayments and repayments of withdrawn contributions are also considered as part of the employer provided benefit.[3] In the case of repayment of withdrawn contributions, only the original contribution (not the amount withdrawn or repaid) is considered to generate an employee-provided benefit.[4] After-tax employee contributions and service purchases, including those made with rollover contributions,[5] are considered employee provided (assuming the requirements of §415(c) limiting the amount of annual contributions to a plan have been met) and act to increase the effective §415(b) limit. It is very common (at least for people retiring today) for there to be a combination of §414(h) pick-up contributions, after-tax employee contributions, formerly withdrawn but repaid contributions, and service purchase contributions in the member's employee contribution account.

Determining how much the effective limit is increased by these contributions involves historical research, possibly 30 or more years into the past, and quite a few calculations. Each after-tax contribution, rollover, etc. must be assigned to a specific plan year and credited with interest at rates specified in IRC §411(c).[6] For plan years beginning prior to 1976, the specified interest rate is the plan's crediting rate for member contributions. For plan years beginning after December 31, 1975 through December 31, 1987, the specified interest rate is 5%. For plan years beginning after December 31, 1987, the specified interest rate is 120% of the midterm applicable federal rate (AFR) in effect for the first month of the plan year (not the limitation year).

The accumulated value of after-tax contributions and service purchases (that met the requirements of §415(c)), must then be converted into an annuity in straight life form in order to determine the effect on the §415(b) limit. The conversion to an annuity is done using "minimum present value segment rates" and the applicable mortality table. The IRS updates the segment rates each month and the applicable mortality table annually.

The stated dollar limit applies to individuals retiring between ages 62 and 65. For those retiring prior to age 62, the limit may be less than the limit that applies at age 62. In governmental plans, the limit is not reduced for public safety personnel with at least 15 years of full-time service providing Police, Fire or EMS services. It is also not reduced for members of the U.S. Armed Forces with 15 years of service[7] and in cases of pre-retirement death and disability benefits. In order to determine the reduced limit, two separate calculations are made and an amount equal to the lesser of items 1) and 2) is chosen, as follows:

1) The first calculation is the actuarial equivalent of a straight life annuity commencing at the annuity starting date that has the same actuarial present value as a deferred straight life annuity in an amount equal to the unreduced limit commencing at age 62. For this calculation, actuarial

[3] Treas. Reg. §1.415(b)-1(b)(2)(ii).
[4] Treas. Reg. §1.415(b)-1(c)(6) Example 12.
[5] Treas. Reg. §1.415(b)-1(b)(2)(v).
[6] Treas. Reg. §1.415(b)-1(b)(2)(iii).
[7] Treas. Reg. §1.415(b)-1(d)(3).

equivalence is based upon 5% interest and the "applicable mortality table" that the IRS publishes annually. This calculation reduces the limit by approximately 6% to 7% for each year that retirement occurs prior to age 62. Commonly, mortality before age 62 is taken into account for this calculation. Mortality prior to age 62 can be ignored in certain situations, resulting in a somewhat higher limit. One example wherein pre-62 mortality can be ignored would be a plan that provides a qualified pre-retirement survivor annuity (as defined in IRC §417(c)) at no cost to the participant both before age 62 and after age 65.[8] (See Revenue Ruling 98-1 Q&A 6.)

2) For the second calculation, the ratio of (a) to (b) below is calculated without regard to the provisions of §415(b), where:

   (a) is the benefit payable under the plan at commencement age; and
   (b) is the deferred benefit that would be payable if the participant terminated employment on the retirement date and waited until age 62 to draw the benefits.

   To complete the second calculation, the unreduced age 62 §415(b) limit is then multiplied by the ratio of (a) to (b).

For example, a member retires at age 55 with a formula benefit of $250,000 payable at age 62. Instead of waiting until age 62, the plan allows the member to receive a reduced benefit of $145,000 at age 55. Suppose the statutory limit at age 62 is $230,000 and the age-adjusted statutory limit (based on 5% interest and the applicable mortality table) at age 55 is $141,000. To calculate the age-adjusted §415(b) limit for this member, a comparison of the following is made:

1) (a) Statutory limit at age 62: $230,000
   (b) Age adjusted limit (based on 5% and applicable mortality table) at age 55: **$141,000**

2) (a) Plan benefit at age 62: $250,000
   (b) Plan benefit at age 55: $145,000
   (c) Ratio (b ÷ a): 0.58
   (d) Statutory limit at age 62 x ratio: $230,000 x 0.58 = **$133,400**

The age-adjusted §415(b) limit is the lesser of 1(b) and 2(d), or **$133,400.**

The limit may be increased for retirements after age 65. This only occurs in plans that provide a "late retirement adjustment." (Note: Benefit accruals that continue after age 65 are not considered a late retirement adjustment.) The increased limit is calculated as the lesser of two values in a manner very similar to the above.

The limit is reduced proportionately for people with less than 10 years of participation in the plan. The participation requirement is ignored in the case of pre-retirement death and disability benefits in a governmental plan.[9]

There are special rules regarding the treatment of Cost-of-Living Adjustments or "COLAs." Internal Revenue Code §415(b) and the associated regulations were written mostly from the perspective of ERISA plans, which rarely provide any type of COLA. Many governmental plans and church plans (particularly those covering ordained ministers) provide COLAs. The term "straight life annuity" in the regulations, and as used above, refers to an annuity whose monthly or annual amount is a level amount that never changes, not even for a COLA.

For example, suppose that a plan participant retires at age 62 with a benefit of $200,000 per year in a year when the age 62 limit is $230,000. In addition, suppose the plan also provides a guaranteed annual COLA of 3%. Since the $200,000 that will be paid is less than the §415(b) limit, it would be easy to

[8] Treas. Reg. §1.415(b)-1(d)(2)(ii).
[9] Code §415(b)(2)(I).

imagine that the full benefit can be paid from the plan in the year of retirement. Unfortunately, that is not necessarily the case. It depends on the specifics of the plan document. Absent special provisions in the plan document, the regulations require that for testing purposes the benefit be converted to an equivalent straight life benefit (i.e., without a COLA) before comparison with the limit. A straight life benefit (in other words, a benefit with no COLA) equivalent to the $200,000 plus COLA benefit described above might be approximately $275,000, which would be $45,000 over the limit. As a result, only $155,000 could actually be paid from the qualified plan. Some plans apply the §415(b) limit in this manner, although the result is not intuitive. After all, the benefit to be paid in the year of retirement is less than the §415(b) limit and, depending on the rate at which the limit goes up, it might actually be less than the limit in every future year. When the calculation is done this way (testing with benefit converted to an amount reflecting future COLAs), no future testing is required. If the benefit passes this initial test, the plan benefit with the formula COLA can always be paid even if, in some future year, the benefit with COLA exceeds the future limit.

The regulations provide for a different treatment of COLAs if the plan is written to permit it. The form of benefit without regard to the COLA must satisfy the requirements of §415(b) and the plan must provide that "in no event will the amount payable to the participant under the form of benefit in any limitation year be greater than the §415(b) limit applicable at the annuity starting date…as increased in subsequent years pursuant to §415(d) and Treas. Reg. §1.415(d)-1."[10] The required language is specified in Treas. Reg. §1.415(b)-1(c)(5)(iii). In simple terms, this means that with the proper plan language, automatic COLAs can be ignored for §415(b) testing provided that each year's benefit is retested against the then current limits. The regulations provide a "safe harbor" method[11] for the retesting that usually results in (employer-provided) benefits being permitted to increase at the same rate as the age adjusted 415(b) limit increases each year.

In a large plan, additional administrative costs may apply because hundreds of cases may require annual retesting which involves maintaining data related to §415(b) calculations for certain individuals for 20, 30 or 40 years.

After Retirement …

For plans that have incorporated the language of Treas. Reg. §1.415(b)-1(c)(5)(iii), detailed testing is done in the year of retirement and the original limited amount payable from the plan, the age at retirement, the age adjusted limit, and the amount attributable to employee contributions ("Ee Portion") are computed as of the retirement year and stored indefinitely. The safe harbor method provided in §1.415(d)-1(a)(6) can then be applied in future years to determine the amount payable from the plan in those years. For such plans, the safe harbor method then provides that the amount payable in the current year is:

$$\text{(Original Amount Payable - Ee Portion) x } \frac{\textit{Age Adjusted Limit in Current Year}}{\textit{Age Adjusted Limit at Retirement}} \text{ + Ee Portion}$$

A nearly equivalent version of this formula, that may be easier to implement, is based upon amounts payable in the preceding year and is shown below.

$$\text{(Amount Payable Preceding Year - Ee Portion) x } \frac{\textit{Age Adjusted Limit in Current Year}}{\textit{Age Adjusted Limit in Preceding Year}} \text{ + Ee Portion}$$

The age adjusted limits are always based upon the age at original retirement. The amount designated as "Ee Portion" normally does not change. In particular, it does not increase with the plan's cost-of-living adjustment.

Adjustments to the safe harbor formula may be required if the benefit amount changes for reasons other than the plan's cost-of-living adjustment. There can be cases where the safe harbor method cannot be applied exactly in this form. One example would be a case of a benefit that changes at Social Security age.

[10] Treas. Reg. §1.415(b)-1(c)(5)(iii).
[11] Treas. Reg. §1.415(d)-1(a)(6).

Code §415(b) limits apply to benefits provided through a "*qualified plan*" by an *employer*. For testing benefits against §415(b) limits, all qualified defined benefit plans maintained by a given employer are combined and treated as one plan. Although it goes without saying, §415(b) limits the benefits an *employer* can provide through its defined benefit plans. Conceivably, an individual could work for two separate employers (i.e., two different governments, one church and one government, etc.) and accrue two separate benefits that, in total, would exceed the §415(b) limit. There are no rules against that situation. Additionally, Code §415(b) does not in any way place a limitation on what an individual can receive in the form of retirement benefits. Unfortunately, at least in the governmental sector, it is not always completely clear when two employers are different from each other. In cases of doubt, plan administrators should obtain legal advice.

Can an employer pay the remaining benefit to the member if the member's benefit is more than the §415(b) limits? Yes, employers can provide the amount of the benefit that exceeds the §415(b) limits through "Excess Benefit Plans." Code §415(m) provides for "Qualified Governmental Excess Benefit Arrangements" or "QEBAs." Such QEBAs are commonly used to pay the portion of benefits that would otherwise be prohibited by §415(b), although they cannot be used to provide benefits that would otherwise be prohibited by the §401(a)(17) compensation limit. QEBAs are separate entities from the qualified plan, although they may be administered by the same staff.

There are unresolved §415(b) issues related to ad hoc COLAs and other types of one-time adjustments to benefits after retirement. These issues also occur in connection with return to work retirees who accrue a new benefit and in case of retirees who participate in more than one plan provided by the same employer and who begin drawing benefits from the plans at different times.

In such situations, the amount of the benefit increase (or the additional benefit due to the second retirement) is treated as a new retirement benefit at a new retirement date. The terminology for this situation is "multiple annuity starting date." The subject of multiple annuity starting dates appears in the regulations, but the description of how to handle them is incomplete. The regulations require the plan to "actuarially adjust the past and future distributions with respect to benefits that commenced at the other starting dates" in order to determine the annual benefit for a participant at a particular starting date.

The regulations also state that in the case of limitation years to which Treas. Reg. §1.415(b)-2 applies, the adjustment is to be made using the rules in Treas. Reg. §1.415(b)-2. Unfortunately, Treas. Reg. §1.415(b)-2 is blank at the time of this writing, so there is no definitive guidance. Until the IRS completes Treas. Reg. §1.415(b)-2, multiple annuity starting dates have to be resolved by a good faith effort to comply with the provisions of §415(b). A discussion with qualified tax counsel would be appropriate when this situation occurs.

TAMRA Election

The Technical and Miscellaneous Revenue Act (TAMRA) of 1988, Public Law 100-647 (102 Stat. 3342), added §415(b)(10). Section 415(b)(10) provides rules for state and local government plans where the employer elected before the close of the first plan year beginning after December 31, 1989, to have § 415(b) apply. These rules provide that for participants who commenced participation in such a plan prior to 1990, the §415(b) limitation shall not be less than the accrued benefit under the plan, determined without regard to any amendments made to the plan after October 14, 1987. Thus, for these participants, benefits which continue to accrue under the terms of the plan as of October 14, 1987, will be treated as not exceeding the §415(b) limitation. For example, an individual who was a member of a plan prior to January 1, 1990 that made the TAMRA election at the appropriate time retires in 2020 with a benefit of $300,000. This member would be able to receive the full $300,000 (which exceeds the current dollar limit) directly from the plan provided that the

$300,000 was calculated based on the plan provisions in effect as of October 14, 1987 (using current service and earnings, but based on the definition of those items as of October 14, 1987). For participants who first became members on or after January 1, 1990, the applicable §415(b) limitation is determined without regard to the TAMRA election.

Conclusion

We encourage all retirement plans to have a well-planned process for testing compliance with IRC §415 and, in particular, for testing compliance with §415(b) and its regulations. A model process would have both legal and computational aspects.

Legal Aspects: The plan document should describe how §415(b) is to be implemented and how benefits are to be determined in cases where the §415(b) limit may affect the amount that can be paid. A number of ambiguities can be eliminated if the plan document defines whether the §415(b) limit is applied to the straight life form of payment prior to the election of any optional forms, or only to the optional form after it has been determined. (Recall that in the plans that are the subject of this *GRS Perspectives*, the accrued benefit is not limited by §415(b), only the benefit that is actually paid).

For example, suppose that the plan document applies the limit to the normal form, and the normal form is a straight life annuity, and that a plan participant retires at age 62 and elects a joint and 50% survivor option covering the spouse. If the retired participant dies prior to the spouse, the spouse is eligible to receive only 50% of the §415(b) limited benefit (directly from the plan). However, if the plan document applies the limit to the optional form (in this case the 50% joint and survivor), the spouse may be eligible to receive up to half of the formula benefit without regard to the §415(b) limit.

In plans that provide an automatic COLA, consideration should be given to the treatment of the COLA, and in particular to the language described in Treas. Reg. §1.415(b)-1(c)(5)(iii) and the special rules regarding COLAs on pages 5 and 6. Creation of such a document would usually involve the services of an attorney who is an expert in these matters.

Computational Aspects: In most plans, simplified procedures may be applied to test the vast majority of retiring participants' benefits against the §415(b) limit and to isolate those few, if any, individuals whose benefits are close enough to the applicable limit to warrant detailed testing. Detailed testing can be complicated and may require the services of one or more outside experts, including actuaries, attorneys, accountants or auditors. For plans that have not elected the special treatment of COLAs provided in Treas. Reg. §1.415(b)-1(c)(5)(iii), detailed testing is normally done only once at the time of retirement and determines the amount payable from the plan in all future years. For plans that have incorporated the language of Treas. Reg. §1.415(b)-1(c)(5)(iii), detailed testing is done in the year of retirement and in each subsequent year up to and until the person passes by a sufficient margin to eliminate risk of a future failure. In such cases, care must be taken to ensure that data sufficient for future testing is retained. Data requirements are fairly simple if the safe harbor method is chosen for future testing (and can be used). However, other testing methods may require different data.

Please refer to Appendix A for a concise summary of key §415 provisions for governmental DB plans. If your plan needs additional information regarding §415(b) or assistance with testing, please contact your GRS consultant.

APPENDIX A: SUMMARY OF KEY §415(b) PROVISIONS FOR GOVERNMENTAL DB PLANS (2020)

NOTE: THIS TABLE SUMMARIZES KEY PROVISIONS OF CODE §415, BUT IS NOT INTENDED AS A COMPLETE DESCRIPTION.

TOPIC	SUMMARY
Plan Qualification	The §415 limits are qualification requirements under Code §401(a). A plan that does not adhere to the limits may risk disqualification.
Limitation Year	The §415 limits apply over the "limitation year" which is the calendar year by default. However, an employer may elect any other consecutive 12-month period as the limitation year through a written plan amendment.
§415(b) Dollar Limit	For governmental DB plans, benefits are tested under the §415(b) dollar limit. The unadjusted dollar limit ($230,000 in 2020) applies to benefits commencing between the ages of 62 and 65.
Adjusted Dollar Limit for Benefits Commencing Before Age 62	For a benefit commencing before the participant attains age 62, the dollar limit is reduced to the annual amount of an equivalent straight-life annuity (SLA) at the benefit starting date using a 5% interest rate and applicable mortality table. If the plan provides for a SLA at both the benefit starting date and age 62, a second dollar limit is calculated as the unreduced dollar limit multiplied by the ratio of the plan's annual SLA at the benefit starting date and the plan's annual SLA commencing at age 62. The age-adjusted dollar limit is the lesser of the two dollar limits.
Adjusted Dollar Limit for Benefits Commencing After Age 65	For a benefit commencing after the participant attains age 65, the dollar limit may be increased to the annual amount of an equivalent SLA at the benefit starting date using a 5% interest rate and applicable mortality table. If the plan provides for a SLA at both the benefit starting date and age 65, a second dollar limit is calculated as the unreduced dollar limit multiplied by the ratio of the plan's annual SLA at the benefit starting date and the plan's annual SLA commencing at age 65. The age-adjusted dollar limit is the lesser of the two dollar limits. This increase would only be allowed if the plan's provisions increase the participants' benefits on account of the delayed benefit commencement.
Exception to Age-Adjusted Dollar Limit	In governmental DB plans, no age reduction in the §415(b) dollar limit before age 62 is required for a participant who has at least 15 years of service in the plan as: (1) a full-time employee of a governmental police or fire department providing police, firefighting, or emergency medical services; or (2) as a member of the U.S. Armed Forces.
Benefits Taken into Account for Testing Under §415(b)	The §415(b) limit applies to the employer-provided portion of the benefit and does not include the portion attributable to mandatory, after-tax employee contributions. Employee contributions picked-up by the employer under 414(h)(2) are included in the employer-provided benefit. Voluntary employee contributions are treated as made to a separate defined contribution plan and are not included in the benefit tested under §415(b), but are included in the defined contribution benefit tested under §415(c).
Benefits Not Taken into Account	Certain ancillary benefits are not taken into account for testing under §415(b), including: (1) the additional dollar value of a qualified joint and survivor annuity; (2) pre-retirement disability benefits that do not exceed the retirement benefit payable at normal retirement age; (3) pre-retirement incidental death benefits; and (4) post-retirement medical benefits.
Form of Benefit Tested	If the DB benefit is in a form other than a SLA, it is converted to an actuarially equivalent SLA beginning at the same age for testing against the §415(b) dollar limit. The factors used to convert a benefit depend on whether the form of benefit is "subject to §417(e)(3)" or "not subject to §417(e)(3)." Benefits that are subject to §417(e)(3) include: full and partial lump sum distributions, period certain only distributions, and others. Benefits that are not subject to §417(e)(3) include: nonqualified joint and survivor annuities, period certain and life annuities, pop-up options, and others.
Adjusting Benefits Not Subject to §417(e)(3)	In adjusting a benefit not subject to §417(e)(3), the value of the equivalent SLA is the greater of: (1) the annual amount of a SLA (if any) payable to the participant under the plan at the same annuity starting date; and (2) the annual amount of a SLA at the same annuity starting date determined using a 5% interest rate and the applicable mortality table.
Adjusting Benefits Subject to §417(e)(3)	In adjusting a benefit subject to §417(e)(3), the value of the equivalent SLA is the greatest of the annual SLA commencing at the same annuity starting date that has the same present value as the benefit payable, computed using: (1) the interest rate and mortality table specified by the plan for actuarial equivalence; (2) a 5.5% interest rate and applicable mortality table; and (3) the applicable §417(e)(3) interest rate and applicable mortality table with the result divided by 1.05.
Adjusting the Benefit for Mandatory, After-Tax Employee Contributions	Mandatory after-tax employee contributions are not included in the employer-provided benefit tested under §415(b). The value of the benefit attributable to these contributions is determined by: (1) applying interest on the contributions using interest rates specified under Code §411(c); and (2) converting the value of the contributions plus interest to an annuity using the applicable §417(e)(3) interest rates and applicable mortality table. The benefit attributable to these contributions is excluded from the employer-provided benefit tested under §415(b). A similar approach is used for rollovers to purchase service credit in a DB plan.
Adjusting the Benefit for Automatic COLAs	Automatic cost-of-living adjustments (COLAs) may be excluded from the benefit tested under §415(b) provided the following conditions are met: (1) the plan document specifically limits the actual benefit paid in any year to no more than the §415(b) dollar limit for that year, adjusted for commencement age and form of payment; and (2) the form of benefit is not subject to §417(e)(3). Otherwise, the value of the benefit tested under §415(b) would need to include the full value of the automatic COLAs.
Adjusting the Dollar Limit for Inflation	Under Code §415(d), the IRS periodically adjusts the §415(b) limits for inflation, based on the CPI, and rounded down to a multiple of $5,000. The adjusted dollar limit is effective as of January 1 of each calendar year and applies with respect to limitation years ending with or within that calendar year. A plan may increase benefits otherwise limited by the §415 limit, including those for participants who have retired, but only if the plan explicitly permits such increases and does so in accordance with the regulations.

About the Author

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