ASPPA
WORKING FOR AMERICA'S RETIREMENT

Further Comments on Proposed Regulations Relating to Limitations on Benefits and Contributions Under Qualified Plans (IRC §415)

October 12, 2005

Department of Treasury
Internal Revenue Service
REG-130241-04

The American Society of Pension Professionals & Actuaries (ASPPA) appreciates this opportunity to further comment on the proposed amendments to the regulations under Internal Revenue Code (IRC) §415 that provide guidance regarding limitations on benefits and contributions under qualified plans (Proposed Regulations).

ASPPA is a national society of retirement plan professionals. ASPPA's mission is to educate pension professionals and to preserve and enhance the employer-sponsored pension system. Its membership consists of more than 5,500 actuaries, plan administrators, attorneys, CPAs, and other retirement plan experts who design, implement and maintain qualified retirement plans, especially for small to mid-size employers.

This letter is a supplement to ASPPA's prior comment letters submitted on July 25, 2005, and August 10, 2005. This third letter provides some additional analysis on issues we raised in the prior two letters. Although the comment period has passed, we respectfully request the Treasury to consider these supplemental comments.

Summary of Recommendations

The following is a summary of ASPPA's recommendations. These are described in greater detail in the "Discussion of Issues" section.

- If a plan provides a benefit accrual based on post-severance pay, as permitted under the §415 rules, in all cases, the accrual should be treated as earned by an active employee.

- Modifications to the multiple annuity starting date rule should be made so that full benefits properly accrued can be paid out without violating §415, solely because of modifications to interest rate assumptions used to determine the applicable limit. In addition, to the extent the payment of an optional form of benefit available to a participant cannot be made in full without violating the §415 limits, an exception should be created to the §411(a) requirements, which would allow the optional form to be reduced to the amount necessary to satisfy §415.

- A correction is needed to address IRC §§125(a) and 132(f)(4) deferrals in the alternative definitions of compensation. ASPPA believes there was an inadvertent omission of statutorily-included elective deferrals in the alternative definitions of compensation prescribed by the regulations.

Discussion of Issues

A. Nondiscrimination Testing Implications of Post-severance Compensation Received in Year After Termination

ASPPA wishes to clarifyand emphasize the comment made in Part B, Subsection 5, of our August 10, 2005, comments regarding the nondiscrimination testing implications of participants who receive post-severance compensation in the plan year following the year of termination of employment (Carryover Year).

Because any benefit accrual based on post-severance pay is attributable to the time that the participant actually worked, it is appropriate that the benefit accrual be treated as earned by an active employee in the Carryover Year. This will ensure that all accruals on post-severance pay will be taken into account under the plan's nondiscrimination test for active employees and will not require the plan to evaluate the accrual under a separate nondiscrimination test for former employees. If the plan does not provide for an accrual in the Carryover Year, the participant should be treated as a former employee for the entire year and, thus, not included in the employee census for the Carryover Year with respect to coverage and nondiscrimination testing.

B. Interrelationship of the Nonforfeitability rules of IRC §411(a) and the Maximum Benefit Rules of IRC §415

The proposed regulations highlight two instances of conflict between IRC §§415 and 411. The first relates to certain distribution patterns that involve multiple annuity starting dates and the second relates to the *de minimis* $10,000 benefit under §415(b)(4) .

1. Multiple Annuity Starting Dates

There are two situations in which the §415 limit is not actuarially increased for later benefit commencement. The first is the §415 dollar limit between ages 62 and 65; the second is the 100% of pay limitation. When either of these limitations applies and multiple annuity starting dates (MASDs) are involved, the proposed §415 regulations provide results that are counter-intuitive, unfair and in conflict with the rules under IRC §411(a).

In general, the maximum benefit under §415 must be adjusted for prior distributions. This requirement applies equally to the dollar limit and to the 100% of pay limit. The adjustment is made to the §415 limit as of the current annuity starting date and essentially reduces the available current §415 limit by the life annuity that is actuarially equivalent to the prior distributions. In addition, if a stream of payments is modified by a new benefit election, the entire annuity stream must satisfy §415 as of the original annuity starting date (with permissible COLA adjustments).

In a situation in which the §415 limit is not increased for later commencement, the application of the basic rule for MASDs requires that the stagnant limit be reduced by actuarially increased prior distributions. This is an “apples and oranges” comparison that results in seemingly unfair benefit restrictions.

Consider a 5% owner, age 71, with a $50,000 average compensation and an accrued benefit of $50,000. In order to satisfy IRC §401(a)(9), the participant begins receiving a life annuity of $50,000 per year.

At age 75, the participant retires. His average pay remains $50,000. The plan provides, as permitted under §401(a)(9), that the participant may make a new election with respect to his benefit at actual termination of employment. The participant elects a lump sum that is the actuarial equivalent of the remaining payments on his $50,000 life annuity.

In order to show compliance with §415, the plan must demonstrate that

- The entire stream of payments satisfies §415 as of the original annuity starting date
    - Assuming interest rates have not declined since the original annuity starting date (ASD), this requirement should be met

- The lump sum benefit must satisfy the §415 limit as of the current ASD after adjustment for prior distributions
    - The lump sum will be the actuarial equivalent of the
        - Current §415(b) limit reduced by the life annuity equivalent of the prior distributions
    - Maximum lump sum is the actuarial equivalent of
        - $50,000 life annuity at age 75 minus
        - Life annuity equivalent of the $50,000 paid at ages 71, 72, 73 and 74

Thus, the maximum lump sum payable is considerably less than the actuarial equivalent (on a reasonable actuarial basis) of the participant's accrued benefit of $50,000. If the plan limits the lump sum payable to the maximum allowable under §415, it would constitute an impermissible forfeiture under §411(a).

This result is simply unfair.

ASPPA recommends that***,*** if a plan so permits, a participant should be allowed to convert the remaining payments in an existing payment stream into an actuarially equivalent optional form (such as a lump sum) without violating §415 or disqualifying the plan. The proposed regulations should provide that the remaining payments in a payment stream, that satisfied §415 as of the original ASD, may be converted to another form of benefit. This conversion would use the applicable mortality table and the greater of 5%, or the plan's actuarial equivalence interest rate applicable to the benefit form being elected.

ASPPA also recommends that the regulations recognize an alternative method for MASDs where the limitation is stagnant. Plans would be limited to the greater of the benefit permissible by this methodology or the methodology of the proposed regulations. In general, a plan should be able to consider the percentage of the §415 limit satisfied by prior distributions and be able to provide benefits equal to the remaining percentage of the limit, with appropriate COLA adjustments.

If the regulations are not altered to allow the conversion of existing benefits under §415, then ***ASPPA suggests*** that the conflict between §411 and §415 be fixed by providing an exception under §411(a) to allow the payment of the lesser benefit (with appropriate information to the affected participant via the Relative Value disclosure) or by providing an exception under §411(d)(6) to eliminate the offending optional forms with respect to the affected participant.

2. $10,000 *De minimis* Benefit

Proposed Regulation §1.415(b)-1(f) provides rules of application for the $10,000 *de minimis* benefit. It makes clear that the $10,000 benefit exception applies without regard to benefit commencement age or to the form of benefit being paid. Example 2 in that regulation section describes a situation in which the benefit payable is $9,500 per year in the form of a life annuity with ten years certain (10 C&L). The example points out that the $9,500 10 C&L benefit is equivalent to $10,400 payable as a single life annuity (SLA), *but does not say that an SLA is available under the terms of the plan.* Because the $10,000 limitation applies regardless of benefit form, the $9,500 10 C&L benefit meets the $10,000 *de minimis* exception of §415(b)(4).

Example 3 points out that, if the plan was to offer a lump sum benefit option, it could no longer take advantage of the $10,000 exception. The benefit payable as a lump sum is $95,000. Because this amount exceeds $10,000, it is not eligible for the exception. The example goes on to point out that the plan could not offer the participant the largest lump sum allowable under §415 (approximately $65,000) because such a distribution would be an impermissible forfeiture under §411(a).

With Example 3 as a backdrop, issues arise in Example 2. Assume the same facts as in Example 2, except that the plan provides for an optional single life annuity, in addition to the 10 C&L normal form. Based on the logic of Example 3, the amount payable as a life annuity could not exceed $10,000 without violating §415. At the same time, if the minimum equivalent of the $9,500 10 C&L benefit (on a reasonable actuarial basis) is an SLA benefit of $10,400, limiting the SLA to $10,000 would be a violation of §411(a).

In order to avoid this conflicting result, the normal form of benefit under a plan using the $10,000 exception would have to be the least valuable benefit option allowed under the plan. Even the use of a "hard-dollar cap" on the normal form at a level below the $10,000 statutory cap may fail due to post-NRA actuarial increases. ASPPA suggests that this approach is unnecessarily restrictive and may lead to inadvertent plan disqualification.

Rather***, ASPPA recommends*** an exception to the §411(a) requirements that would allow the optional form to be reduced, in this situation, to the amount necessary to satisfy §415. To safeguard the rights of participants, however, ASPPA suggests that if this methodology is used, the Relative Value disclosure to the participant that is given as part of the QJSA Notice be required to be provided on a personalized, rather than a generic, basis.

C. Correction Needed to Address IRC §§125(a) and 132(f)(4) Deferrals in Alternative Definition of Compensation

IRC §415(c)(3)(D)(2) provides that compensation for purposes of §415 includes deferrals under IRC §§402(g)(3), 125, 132(f)(4) and 457. The general definition of compensation contained in §1.415(c)-2(b) of the Proposed Regulations refers to each of these income deferral amounts as being part of §415 compensation. However, the alternative safe harbor definition of compensation contained in §1.415(c)-2(d)(3) [the "Section 3401(a) wages" alternative] refers to the §§402(g) and 457 deferrals, but does not include the §§125 and 132(f)(4) deferrals. The §3401(a) wages alternative definition is also used as the starting point for the alternative definition contained in §1.415(c)-2(d)(4) (the "information reporting" alternative definition). In accordance with IRC §415(c)(3)(D)(2), both the Section 3401(a) wages and the information reporting alternative definitions of compensation should include deferrals under IRC §§125 and 132(f)(4).

Accordingly, ***ASPPA recommends*** that §1.415(c)-2(d)(3) of the Proposed Regulations be revised specifically to include deferrals under IRC §§125(a) and 132(f)(4).

These comments were prepared by ASPPA's Government Affairs Committee IRS Subcommittee, Mark L. Lofgren, Esq., APM, Chair, 401(k) Subcommittee, Virginia Krieger Sutton, Chair, Defined Benefit Subcommittee, David Lipkin, MSPA, Chair, and Tax-Exempt and Government Plans Subcommittee, L. Joann Albrecht, CPC, QPA, Chair. Please contact us if you have any comments or questions regarding the matters discussed above. Thank you for your consideration of these comments.

Sincerely,

Brian H. Graff, Esq. APM Executive Director	Teresa T. Bloom, Esq., APM, Co-chair Gov't Affairs Committee
Ilene H. Ferenczy, Esq., CPC, Co-chair Gov't Affairs Committee	George J. Taylor, MSPA, Co-chair Gov't Affairs Committee
Sal L. Tripodi, Esq., APM, Co-chair Gov't Affairs Committee	Robert M. Richter, Esq., APM, Chair Administrative Relations Committee