



Workshop 28 Actuarial Potpourri

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What We are Covering

- 412(d)(2) elections
- Insurance
- Issues with in kind distributions
- Real Estate
- Actuarial increases

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412(d)(2)/412(c)(6) Elections

- IRC 412(d)(2)/412(c)(6)
 - Has not changed since 1974
 - The plan must have an election to recognize an amendment executed after the valuation date
 - Historically were used to recognize amendments executed within 2½ months after plan year end
 - Issue results from IRS Rev Proc 2007-44
 - Discretionary amendments may not be retroactive to the prior plan year
 - Potential disqualification

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412(d)(2)/412(c)(6) Elections

- Has not changed since 1974
- Election is a 412/404 issue
- Issue results from IRS Rev Proc 2007-44
 - Discretionary amendments may not be retroactive to the prior plan year unless under 1.401(a)(4)-11g
 - Potential disqualification

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412(d)(2)/412(c)(6) Elections

- Can a Rev Proc override a statute?
- Where are we?
 - Instances where IRS examiners have come across situations have suggested CAP
 - Currently these cases in for determination letters are being held in suspense
 - Some movement on the issue
- Recommendation-Don't use 412(d)(2) for amendments adopted after close of the plan

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Life Insurance

- §1.401(a)(4)-4 BeFR Amount of insurance non-discriminatory
 - Face amount of Insurance in DB plan which meets 401(a)(4) on its own may be proportional to projected benefit
 - Where DB plan benefit structure does not meet 401(a)(4) on its own
 - Proportional to compensation
 - Flat dollar amount
- Incidental to primary purpose of a retirement plan
 - 100 x projected benefit rule
 - IRS Revenue Ruling 74-307-maximum face amount based on ILP funding



Life Insurance

- Watch out for Listed transactions
 - IRS Rev Rul 2004-21-Rights under insurance policies must be the same for all participants
 - Whole life for HCEs and term for NHCEs is prohibited
 - IRS Notice 89-25 Q&A 10/IRS Rev Proc 2004-16 prohibiting springing cash value policies
 - Excess life insurance



Life Insurance

- Example 1:
 - Accrued benefit is equal to 2% of compensation for each year of participant to a maximum of 10 years.
 - Benefit formula complies with 401(a)(4)
 - Plan may provide for insurance under the 100x rule or Rev Rul 74-307 methodology

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Life Insurance

- Example 2:
 - Accrued benefit is equal to 2% of compensation for each year of participant to a maximum of 10 years for HCEs and 0.5% of compensation for each year of participant to a maximum of 10 years for HCEs
 - Benefit formula does not comply with 401(a)(4) on its own. Therefore insurance based projected benefits is discriminatory

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Life Insurance

- Example 2:
 - Therefore provide for life insurance equal to compensation
 - NHCEs compensation is \$48,000. Life insurance is therefore \$48,000.
 - Projected benefit under formula is $0.5\% \times 10 \times \$48,000 \times 100 / 12 = \$20,000$
 - Insurance meets 401(a)(4) but likely fails the incidental benefit test

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PPA Funding for Life Insurance

- Fund for death benefit premiums are not relevant
- Insurance is treated as an asset
- If the funding assumptions assume no pre-retirement mortality then life insurance does not increase plan costs directly
- If the funding assumptions assume pre-retirement mortality then moderate increase in plan cost
- With the ability to use the cushion, is an ancillary benefit needed?

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In Kind Distributions

- Non-publicly traded investments
 - Who determines the value?
 - Trustee/Participant-Conflict of Interest
 - Independent Appraiser-Appraisal fee might cost more than the asset is worth.
 - Publicly traded investments-determine values prior to distribution or after settlement
 - Unpleasant surprises
 - Apportion assets among participants

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Real Estate

- Determination of Value
- Prohibited Transaction
- Unrelated Business Taxable Income
- Trade or Business

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Late Retirement Issues

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Focus

- Small plan where the concerns are the issues that apply with respect to business owner (or highly compensated employee)
- Note that most of discussion can be applied to non-highly compensated employees too, but not the focus
- Want to design to avoid the issues (if possible)

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Situations That Arise

- Owner Starts Plan “Late”
- Owner Keeps Working Past Normal Retirement Age (i.e., works “Late”)
- Owner Keeps Working Past Required Beginning Date (really works “Late”)

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Situations That Arise

- Definition of “Late” – after age 62 or after age 65, really after normal retirement age (NRA)
- Definition of “Late” – after age 70 ½, a separate category

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Applicable Law



Normal Retirement Age (NRA)

- Not later than later of age 65 or 5th anniversary of commencement of participation
- Driver of other rules

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Normal Retirement Age (NRA)

- Requirements
 - Benefits become nonforfeitable
 - Accrual rules pegged to
 - Trigger for actuarial increase later
 - Trigger for suspension of benefit rules later
 - Trigger for statutory commencement date

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Continued Accruals After NRA

(IRC §411(b)(1)(H))

- Benefit accruals may not cease because participant attains NRA
- If distributions have begun under the plan actuarial equivalent of benefits distributed in-service may offset additional accruals
- If distributions have not begun under the plan
 - May provide notice of suspension of benefits
 - May provide an actuarial increase to the normal retirement benefit and offset benefit accruals

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Suspension of Benefits (§2530.203-3(b))

- Plan administrator must provide (personal delivery or first class mail)
- Must describe when and why benefit payments are suspended after participant attained normal retirement age
 - Describe when benefits may be suspended
 - Must provide a copy of the specific plan provisions and describe appeals process

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Suspension of Benefits (§2530.203-3(b))

- Must receive notice in the first month benefits are suspended
 - Late retirement – month participant attains NRA
 - Rehired retiree – first month that a benefit is suspended

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Suspension of Benefits (§2530.203-3(b))

- What happens if fail to provide suspension notice?
- Revenue Ruling 81-140, Situation 1 says you have to give actuarial increase
- Contilli case appears to say the same

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Post-NRA Actuarial Increase Pre-70 1/2

- Plan which does not suspend benefits must provide for actuarial increases post NRA
- The methodology and extent of the actuarial increase should be stated in the plan document
- The plan may provide the greater of the actuarial increase or the benefit of continued accruals under the plan formula
- Alternatively the plan may provide both the continued accrual and the actuarial increase

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Post-NRA Actuarial Increase Pre-70 1/2

- Heinz decision restricts ability of plan to add a suspension of benefits rule to the plan with respect to only *future accruals*
- Also, may want to look at 2009 Gray Book Q&A 39

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Required Minimum Distributions (§ 401(a)(9))

- Benefits must commence by the “required beginning date”
 - April 1 following later of age 70½ or termination of employment for non-5% owners, or, plan may use April 1 following age 70 ½ for all
 - 5% owners - April 1 following age 70½

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Required Minimum Distributions (§ 401(a)(9))

- Benefits will be recalculated each year after initial commencement if paid in-service
 - Reflect additional accruals for years of service after commencement
 - May offset actuarial increase by value of benefits paid if plan so provides

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Statutory Normal Commencement Date (§401(a)(14))

- Unless the participant otherwise elects, the payment of benefits under the plan to the participant will begin not later than the 60th day after the latest of the close of the plan year in which –
 - The date on which the participant attains the earlier of age 65 or normal retirement age under the plan,
 - Occurs the 10th anniversary of the year in which participation commenced, or
 - The participant terminates service with the employer.

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§ 415 Rules

- 100% Compensation limit –
 - 10 years of service phase-in
 - Compensation for a year limited to § 401(a)(17) amount
 - No actuarial adjustment for post-65 retirement
 - Of course, high-3 year average, but COLA applied post-termination only

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§ 415 Rules

- Dollar limitation –
 - 10 years of participation phase-in
 - Adjustment for post-65 commencement
 - Dollar limit adjusted for COLAs

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Situations That Arise



Starts Plan Late

- Owner age 62 or greater
- Desire to maximize benefit
- Assume 10+ years of service

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Starts Plan Late

- Need to look at high 3 year average compensation compared to § 415 dollar limit
- If compensation is far below dollar limit, may want to put off NRA as long as possible
- HCE intends to continue working past age 65

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Starts Plan Late

- Example 1
 - HCE is age 64 with high-3 average of \$120,000
 - § 415 limit is \$210,000
 - Can have an accrued benefit of \$21,000 times years of participation up to 10 years (ignoring increases for now)
 - Will reach \$120,000 in 6th year

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Starts Plan Late

- Example 1 (cont.)
 - Progression of accruals

Year	Age	Accrued Benefit
1	65	\$21,000
2	66	\$42,000
3	67	\$63,000
4	68	\$84,000
5	69	\$105,000
6	70	\$120,000

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Starts Plan Late

- Example 1 (cont.) - NRA of 65
 - Would need to either suspend benefits or actuarially increase benefits
 - Suspension route is not a good idea
 - Actuarially increasing benefits causes a problem too

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Starts Plan Late

- Example 1 (cont.) – NRA is age 65
 - At age 66 the \$21,000 needs to be actuarially increased. Let's assume 7% is the factor
 - Pattern becomes

Year	Age	Accrued Benefit
2	66	43,470
3	67	67,513
4	68	93,239
5	69	120,000

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Starts Plan Late

- Example 1 (cont.) – NRA is age 65
 - Increases stop at age 69 (end of year 5)
 - Reach 120,000 one year earlier
 - Benefits need to commence at 120,000

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Starts Plan Late

- Example 1 (cont.) – NRA is age 69
 - No increases needed; original pattern stays
 - At age 69 (end of year 5) have earned 105,000
 - Benefit that needs to commence is only 105,000 not 120,000
 - Note that dollar limit adjustment for post-65 does not help matters in either case, but coincides with plan increases by design of example

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Starts Plan Late

- Consider if want to suspend benefits
 - If not assumed for funding, probably should suspend
 - If plan assets have taken a loss, may want to suspend
 - If assumed payment for funding, then probably should pay unless asset loss

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Starts Plan Late

- Example 2
 - High-3 year average compensation is \$240,000
 - There will be increases in dollar limit and accrued benefit
 - Compensation limit is not a factor

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Starts Plan Late

- Example 2 (cont.) – NRA is 65
 - Accruals result in

Year	Age	Accrued Benefit
1	65	21,000
2	66	44,940
3	67	72,129
4	68	102,904
5	69	137,634

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Starts Plan Late

- Example 2 (cont.) – NRA is 65
 - Have AB increasing but plan language will need to be careful about accruals
 - Want to accrue 21,000 as adjusted
 - No need to start benefits yet because can still have increases

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Starts Plan Late

- Example 2 (cont.) – NRA is 69
 - Accrual pattern changes

Year	Age	Accrued Benefit
1	65	27,527
2	66	55,053
3	67	82,850
4	68	110,107
5	69	137,634

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Starts Plan Late

- Example 2 (cont.) – NRA is 69
 - Accruing towards benefit payable at age 69
 - Do not have to commence because can have actuarial increases
 - Again want to consider what the funding assumption was and asset values

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Starts Plan Late

- Example 3
 - Hi-3 year average compensation is 120,000 and then jumps to 240,000 at end of 3 years
 - Accrual pattern is now same as example 2
 - Considerations become the same

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Works Late

- HCE has fully accrued benefit at NRA of 65
- Keeps working
- What are choices?
- What is suggested?

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Works Late

- Example 4
 - Has accrued hi-3 year average of 120,000
 - Choices
 - Suspend benefit
 - Commence payment of benefit
 - What was assumed for funding?
 - What is asset value (including contribution)?

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Works Late

- Example 5
 - Has accrued § 415 dollar limit
 - Choices
 - Suspend benefit
 - Commence benefits
 - Actuarially increase benefit
 - Consider funding and asset values, and HCE situation

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Works Late

- Example 6
 - Compensation limit was 120,000 and increases to 240,000 like in example 3
 - Age 65 – choose to suspend or pay benefits
 - If expect pay increases, perhaps better to suspend because AB will increase

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Works Late

- Example 6 (cont.)
 - Ignoring actuarial adjustments for the moment, the pattern of accruals is

Year	Age	Accrued Benefit
10	65	120,000
2	66	160,000
3	67	210,000
4	68	210,000

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Works Late

- Example 6 (cont.)
 - Either suspend or pay benefits up to age 68
 - After age 68, can actuarially increase because at dollar limit
 - Note that if compensation increase is such that below dollar limit, need to just increase payments

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Really Works Late

- Once hits 70 ½, will have to commence benefits for owner (unless stops being owner before calendar year attains 70 ½)
- Commence next April 1, periodic payment or lump sum
- Example 4 – payment of 120,000 can not be suspended any more

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Really Works Late

- Example 7 (Example 2 in later years)
 - Continues to accrue benefits
 - Picking up pattern from slide 34 have

Year	Age	Accrued Benefit
6	70	176,722
7	71	220,607

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Really Works Late

- Need to commence payment
 - Suggest pay 220,607
 - Accruals continue
 - Additional accrual added next year
 - Can cash out lump sum when finally retires

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