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Comments on Proposed Regulations Relating to Determination of Minimum Required Pension Contributions

July 21, 2008

Department of Treasury
Internal Revenue Service
26 CFR Part 1
[REG-108508-08]

The American Society of Pension Professionals & Actuaries (ASPPA) appreciates this opportunity to comment on the proposed regulations regarding the determination of minimum required pension contributions under Internal Revenue Code (Code) §430 as issued by the IRS and Treasury on April 11, 2008 (REG -108508-08) (Proposed Regulations). All references in this letter to a Section (§) are references to the Code.

ASPPA is a national organization of more than 6,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, administrators, actuaries, accountants and attorneys. Our large and broad-based membership gives ASPPA unique insight into current practical applications of ERISA and qualified retirement plans, with a particular focus on the issues faced by small- to medium-sized employers. ASPPA's membership is diverse but united by a common dedication to the employer-sponsored retirement plan system.

While the Proposed Regulations are a welcome step for practitioners who must apply the new funding rules, ASPPA requests clarification on several issues addressed in the Proposed Regulations, as well as guidance for additional issues not covered. ASPPA also requests the opportunity to testify at the hearing on August 4, 2008.

This comment letter was prepared jointly by ASPPA and the College of Pension Actuaries (COPA) working cooperatively together. Accordingly, both ASPPA and COPA are submitting identical comment letters.

Summary of Recommendations

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

I. Quarterly Contributions

a. Final regulations should clarify that both 90% of the current year minimum required contribution (MRC) and 100% of the prior year MRC amounts are determined as of the respective valuation dates.

b. Final regulations should provide that interest on contributions made before the quarterly contribution due date counts toward meeting the quarterly contribution requirement.

II. Use of Credit Balances

a. Final regulations should permit an election to use credit balances only to the extent necessary to satisfy the minimum required quarterly contribution requirements, where satisfying the requirement includes making sufficient contributions after the quarterly due date to cover the required quarterly plus interest.

b. Final regulations should provide that in determining if there are contributions in excess of the MRC which the employer may elect to add to the prefunding balance (PFB), the MRC is first reduced by any credit balance the employer has elected to apply for the year, as required under §430(f)(3).

c. Final regulations should provide that, for purposes of whether or not a shortfall amortization base must be established, the PFB may be treated as used to satisfy the minimum funding requirement even though it is not reduced to satisfy the funding requirement if the resulting minimum funding requirement is less than the carryover balance (COB) and is fully offset by the COB.

III. Contribution Issues

a. Final regulations should clarify that a contribution made in the current year for a prior year to avoid a §436 problem in the current year is included in assets for the current year, and thus is considered in determining the current year's MRC (and thus the minimum quarterly contribution requirement).

b. Final regulations should clarify that, with the exception of the mandatory election for contributions made to avoid limitations under §436, sponsors can delay electing application of contributions until the filing of the Schedule SB for the year.

IV. Miscellaneous

a. Final regulations should clarify that a funding deficiency for the preceding year is treated as a receivable contribution when determining the MRC for the current year.

b. Final regulations should remove the requirement that assets reduced by carryover and prefunding balances (for determination of funded status and funding shortfall) not be reduced below zero.

c. Final regulations should provide that, where a short plan year follows a 12-month plan year, the required quarterly contribution for a due date during the short plan year cannot be more than 25% of the prior (12-month) year's MRC.

d. Final regulations should coordinate the definitions of funding shortfall in Sections 1.430(a)-1 and 1.430(j)-1(e)(4).

e. Final regulations should provide an example that clarifies whether a plan that fails the gateways under §412(l) but did not have an additional funding charge is ineligible for the shortfall amortization base transition rule.

f. Final regulations should specifically define a "period of underpayment" for quarterly contributions as was provided for liquidity payments.

Discussion of Issues

I. Quarterly Contributions

a. The required quarterly contribution is based on a comparison of 90% of the current year and 100% of the prior year required contributions. Under prior law, the required annual payment (RAP) was the basis for the determination of the quarterly contribution requirements. As noted in Notice 89-52, the RAP is based on "the amount necessary to avoid a funding deficiency as of the end of that plan year". Post-PPA, the determination of the minimum quarterly contribution is determined based on the MRC which, by statute, is determined as of the valuation date for the plan year.

   ASPPA recommends that the final regulations clarify that when comparing 90% of the current year to 100% of the prior year MRCs, both the current and prior year amounts are determined as of the respective valuation dates.

b. The proposed regulations do not address the effect of interest on contributions made before the quarterly due date. The examples in the proposed regulations are limited to situations where the quarterly contributions are made precisely on their due dates. Employers should receive credit for interest with respect to contributions made to satisfy the quarterly contribution requirements before the due dates for such contributions. As noted in the proposed regulations, the proper interest rate for crediting/discounting the contributions would be the effective rate for the year.

ASPPA recommends the final regulation provide that interest on contributions made before the quarterly contribution due date counts toward meeting the quarterly contribution requirement.

II. Use of Credit Balances

The proposed regulations take an approach to the application of credit balances to quarterly contributions that yields troublesome results. The proposed regulations contain an example under which the employer contributes the full MRC for the year (unreduced by credit balances), and yet, due to the timing of the contribution, is forced to "waste" credit balances unnecessarily or be forced to fail the quarterly contribution requirement. This section of our comment letter recommends approaches that, alone or in combination, would solve the problem, while protecting participants and ensuring that there is no gaming of the difference in interest credits between contributions and credit balances. We believe the statute does not literally call for the regulatory interpretation limiting the ability to rebuild the credit balance (see item b. below) and that such an interpretation is inappropriate for policy reasons (see item a. below).

a. The proposed regulations provide that a plan sponsor must make a written election to use a credit balance (COB or PFB) to satisfy a quarterly contribution installment. The proposed regulations also provide that for purposes of determining the PFB, only cash contributions in excess of the MRC (unreduced by any credit balance utilized to satisfy funding requirements for the year) are credited to the PFB. The result is that a plan sponsor who is not comfortable committing cash to the plan early in the year, and who has a sufficient credit balance to cover the quarterly requirement, will have no incentive to contribute the cash later in the year – a result clearly not intended by PPA.

   ASPPA recommends that final regulations permit an election to use a credit balance only to the extent necessary to satisfy the quarterly contribution requirement, where satisfying the requirement includes making sufficient contributions after the quarterly due date to cover the quarterly contribution requirement plus interest. To prevent gaming in the use of credit balances versus cash contributions depending on what the plan asset's rate of return turns out to be for the year, the interest crediting rate could be based on the lesser of the applicable rate or the actual rate of return on plan assets for the year.

   As an example, consider a plan with a $2 million PFB. The quarterly contribution requirement is $200,000. Under our recommendation, the employer could make an election such that, in the absence of a later contribution of at least $800,000 plus interest, the credit balance would be reduced to the extent necessary to ensure that the required installments were satisfied. If, however, the employer makes any contributions for the year, those contributions would reduce the amount of the contingent credit balance application.

It should be noted that the contingent credit balance election assures that the quarterly contribution requirement will be met and thus addresses any PBGC or participant notice requirements.

b. The proposed regulation's requirement that only contributions in excess of the MRC (unreduced by any contribution applied to satisfy the minimum contribution requirement) are to be credited to the PFB is counter-intuitive, and not required by the statute.

   Code §430(f)(3) provides that the MRC for the year is "reduced" by the PFB or COB the employer elects to apply for that year. In other words, the MRC for a year for purposes of §430(f) varies depending on whether or not an election is made to apply some of the credit balance to that contribution. Logically, it is this reduced MRC in (f)(3) that is the MRC referenced in §430(f)(6)(B)(i)(II), that is used to determine the contributions, if any, that are added to the PFB as of the first day of the following year.

   Ignoring interest for purposes of this example, assume the MRC for the year for the plan described in Subsection II(a) above, is $1 million. Assume further that the employer makes a contribution for the plan year, after the fourth quarterly payment is due, equal to $1 million (plus interest). Because the reduced MRC for the year is $200,000 after considering the election to reduce the credit balance, $800,000 of the $1 million contribution exceeds the reduced MRC [as defined by §430(f)(3)] for the year and can be added to the prefunding balance. Thus, the PFB will remain at $2 million.

   ASPPA recommends that final regulations provide that the MRC is reduced by any credit balance the employer has elected to apply for the year, as required under §430(f)(3), in determining if there are contributions in excess of the MRC that the employer may elect to add to the prefunding balance.

c. The proposed regulations provide that, for purposes of determining whether or not a shortfall amortization base must be established, the PFB is subtracted from the value of assets only if a portion of the PFB will be used to satisfy the MRC requirement. In practice, if the plan also has a COB, there can be situations where the MRC determined after subtracting the PFB is less than the COB, so the COB will cover the MRC and there can be no actual application of the PFB to cover the MRC.

   ASPPA recommends final regulations provide that, for purposes of whether or not a shortfall amortization base must be established, the PFB may be treated as used to satisfy the minimum funding requirement if the resulting minimum funding requirement is less than the COB and is fully offset by the COB.

III. Contribution Issues

a. Final regulations should clarify that a contribution made in the current year for a prior year to avoid a §436 problem in the current year is included in assets for the current year, and thus is considered in determining the current year's MRC (and, in turn, the minimum quarterly contribution requirement).

   For example, consider an employer who intended to make a $100,000 contribution for 2009, but makes an additional contribution on April 30, 2010 of $200,000 for 2009 so as to avoid limits on accelerated distributions from that date forward. Since it is for 2009, it is a receivable that is included in December 31, 2009 assets and reduces the January 1, 2010 unfunded as well as the January 1, 2010 minimum and the resulting quarterly requirement that had already gone in for April 15, 2010.

   ASPPA recommends that final regulations clarify that a contribution made in the current year for a prior year, including a contribution made to avoid a §436 problem, is included in assets for the current year. This comment is consistent with ASPPA's earlier comments on proposed §§ 430 and 436 regulations regarding the coordination of the adjustments for each purpose.

b. The proposed regulations at Section 1.436-1(f)(2) provide that contributions made to avoid benefit limitations under §436(b), (c) and (e) must be designated as such at the time the contribution is "used" to avoid or terminate limitations, and can only be re-characterized as a §430 contribution in the event a subsequent AFTAP determination indicates all or part of the contribution was not necessary to avoid application of the §436(b) or (c) [but not (e)] limitation.

   The proposed regulation at Section 1.430(f)-1(b)(1)(II)(B) indicated that a written election is needed to satisfy a quarterly contribution requirement by using a credit balance, but is not specific about the timing of the written election for cash contributions used to satisfy the quarterly requirement. The proposed regulations appear to require that a written election be made at the time the quarterly payment is due if the obligation is satisfied by an existing credit balance, but does not impose a similar requirement for designating the use of contributions. ASPPA believes the final designations of the application of credit balance for purposes other than §436 elections are properly made at the time of the filing of the Schedule SB for the year. This ties the timing of credit balance elections to the time for elections to increase the credit balance as proposed in earlier regulations. Coordinating the timing of the elections solves the problem described in Section II and allows the employer to properly manage the maintenance of credit balances. ASPPA holds the same view for contributions. Affirmative elections about the use of contributions should not be needed prior to the Schedule SB filing for the year.

ASPPA recommends that final regulations provide that, with the exception of the mandatory election for contributions made to avoid limitations under §436, sponsors can delay electing application of contributions to meet the MRC until the filing of the Schedule SB for the year. However, if final regulations tie the written election deadline for contribution and credit balance elections to the quarterly contribution deadline, ***ASPPA recommends*** that the final rule specifically endorse the notion of a "formula" election that adjusts the final amount due to reflect final valuation results, final plan year changes, final prior year contribution results and final §436 elections.

IV. Miscellaneous

a. Proposed regulation Section 54.4971(c)-1 provides that any funding deficiency is to be satisfied by the earliest contribution, and provides that the deficiency affects the current year's determination of the MRC. Example 3 makes this clear observing: "The funding shortfall as of January 1, 2008, is calculated as the difference between the funding target and the value of assets as of that date. The assets are not adjusted by the amount of the accumulated funding deficiency; the fact that the contribution was not made for the 2007 plan year means that the January 1, 2008, funding shortfall is larger than it would have been otherwise."

   By not treating the deficiency as a receivable contribution, the MRC for the current year will be overstated – effectively, the deficiency will have to be paid both as a deficiency, then as part of the current year funding shortfall. This type of double counting would be inconsistent with the concept of reasonable funding methods.

   ASPPA recommends that final regulations clarify that a funding deficiency for the preceding year is treated as a receivable contribution when determining the MRC for the current year.

b. When describing the result of subtracting carryover and PFBs from assets for purposes of determining funded status, or the funding shortfall, the phrase "(but not below zero)" appears in the proposed regulations although it does not appear in the statute [see Code §430(f)(4)(B)]. The statute is correct, and should be followed in the final regulations.

   When determining a plan's funding shortfall, the statute refers to the excess of the funding target over the value of assets [as determined under §430(f)(4)(B)]. The statute appropriately does not limit the assets to a positive number because credit balances in excess of assets should not be permitted to be carried forward without an offsetting charge. Without this change, in a situation where the credit balance exceeds the assets, the §430 funding method would be inconsistent with the concept of a reasonable funding method.

ASPPA recommends that final regulations remove the requirement that assets reduced by carryover and prefunding balances (for determination of funded status and funding shortfall) not be reduced below zero.

c. While the proposed rule generally addresses the issue of a short plan year by adjusting the prior year minimum and the shortfall amortization (which in combination with a target normal cost based on the short period of accrual generally produces a pro-rata MRC), it is possible that the required installment for a short period will exceed the installment that would have been required absent the change. For example, a plan crediting benefits based on a year in which the participant earned 1,000 hours of service might not enjoy proration or reduction in any form of the target normal cost. If, in the absence of the short year, the current year component of the calculation of the quarterly requirement would have governed, the lack of a pro-rate of normal cost can result in an after-the-fact increase in the quarterly requirement.

   For example, a plan has a 12-month calendar year. The required minimum contribution for 2008 was $120,000. The required minimum contribution for 2009 is $88,889 (90% of that is $80,000), which is all TNC. The QCO is $20,000. After April 15, 2009, the plan is amended to have a short year ending July 31, 2009. The QCO is re-determined by taking 7/12th of the $120,000 or $70,000 for the prior year. The 2009 contribution is unchanged. The lesser of $80,000 and $70,000 is $70,000. Since the plan year runs from January 1 to July 31, there are three due dates, April 15, July 15 and August 15. Therefore, the required quarterly amount due is $70,000/3 or $23,333 each. A $20,000 installment paid April 15 would have been sufficient before the short year was created, but insufficient after creation of the short year.

   ASPPA recommends that final regulations provide that the quarterly contribution requirement for a due date during a short plan year cannot be more than 25% of the full plan year required annual payment.

d. The definition of funding shortfall in Section 1.430(a)-1 is not consistent with the Section 1.430(j)-1(e)(4) definition.

   ASPPA recommends that final regulations minimize confusion by using consistent definitions and noting necessary adjustments.

e. The exception from establishing a shortfall amortization base if funded at 100% (without reducing assets for any COB) is not available to a plan that had been subject to the deficit reduction contribution. Confusion exists over whether the exception is available to a plan that was subject to §412(l) because it failed the gateway, but did not actually have an additional funding charge.

ASPPA recommends that final regulations provide examples that clarify eligibility for the shortfall amortization base exclusion for plans subject to §412(l).

f. The period of underpayment used to determine the additional interest charge is different for the required quarterly contributions (payment date) and the liquidity requirement (end of quarter including the payment date) in the statue and proposed regulations. Examples in the proposed regulations illustrate the difference. However, the proposed regulations include a specific "period of underpayment" definition for the liquidity requirement, but not for the quarterly requirement which can lead to confusion.

   ASPPA recommends that final regulations specifically define "period of underpayment" for the required quarterlies.

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These comments were prepared by ASPPA's Defined Benefit Subcommittee of the Government Affairs Committee in cooperation with COPA. ASPPA was represented by Thomas J. Finnegan, MSPA, CPC, QPA; Maureen J. DeSensi, QPA; Mark K. Dunbar, MSPA; William Held, MSPA; Marjorie R. Martin, MSPA; and Kurt F. Piper, MSPA. Please contact us if you have any questions or comments regarding the matters discussed above. Thank you very much for your consideration of these comments.

Sincerely,

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