

## Procedures For Permitting Restorative Payments To Qualified Retirement Plan

September 3, 1999

J. Mark Iwry  
Benefits Tax Counsel  
Department of the Treasury  
Office of Tax Policy  
1500 Pennsylvania Avenue, N.W.  
Room 3111  
Washington, DC 20220

Re: Procedures For Permitting Restorative Payments To Qualified Retirement Plan

Dear Mr. Iwry:

This letter is a follow-up to the recent conference call between Amy Null of your office and Brad Huss, Bruce Ashton, Mike Canan and Jeff Chang of the American Society of Pension Actuaries (ASPPA) Government Affairs Committee. Ms. Null was assigned by your office to analyze and respond to ASPPA's letter dated October 14, 1998 which recommended that the Internal Revenue Service (IRS) issue a revenue ruling providing that restorative payments to qualified retirement plans made by plan sponsors or fiduciaries not be treated as contributions or annual additions to the plans, but be deductible by the plan sponsor, or if appropriate, by the fiduciary.

ASPPA is a national organization of approximately 3,700 members who provide actuarial, consulting, administrative, legal and other professional services for about one-third of the qualified retirement plans in the United States, the majority of which are maintained by small businesses. ASPPA's mission is to educate pension actuaries, consultants, administrators, and other benefits professionals and to preserve and enhance the private retirement system as part of the development of a cohesive and coherent national retirement income policy.

During our conference call with Ms. Null, she raised several issues and concerns on the part of Treasury as follows:

1. Treasury views the fiduciary breach situations which give rise to possible restorative payments as different from restorations of lost earnings under EPCRS and, therefore, believes that restorative payments in connection with fiduciary breach situations should be handled separately from restorative payments of lost earnings under EPCRS.
2. Treasury is concerned that the issuance of a revenue ruling could give rise to abuses in the form of excessive contributions disguised as restorative payments or restorative payments being made in cases where there is no fiduciary breach involved.
3. Treasury is concerned about how plan sponsors, or other responsible fiduciaries, should calculate the lost opportunity cost resulting from the fiduciary breach.
4. Treasury is concerned about the IRS's ability to prevent and monitor abusive correction situations.
5. Treasury is concerned that plan sponsors and fiduciaries might view existing fiduciary rules as having less "teeth" since a program authorizing restorative payments would allow sponsors and fiduciaries to self-correct such breaches.
6. Treasury is concerned about the interplay between the guidance on restorative payments and the prohibited transaction rules.

A closer look at the concerns raised by Treasury suggests the following principal concerns:

1. How can Treasury prevent and monitor abuses of the restorative payment process?

2. What, if any, guidance should be given to plan sponsors regarding the calculation of lost opportunity costs?
3. What happens if a restorative payment situation involves a prohibited transaction?

These principal concerns are addressed in greater detail below.

### **How Can The Treasury Prevent And Monitor Abuses Of The Restorative Payment Process?**

ASPPA agrees that Treasury's concerns about potential abuses of the restorative payment process are legitimate. We also believe, however, that the need for guidance in connection with the making of legitimate restorative payments far outweighs the problems that may arise from potential abusive situations. There is always the potential for abuse by those plan sponsors and plan participants who choose not to "play by the rules." However, our members, and the plan sponsors whom our members advise and assist, understand the need for, and purpose of the various Title I and Title II rules and requirements with respect to qualified plans; and they make every effort to abide by these rules. Therefore, we believe it is not sound policy to penalize those plan sponsors and fiduciaries who wish to self-correct and make good on recognized fiduciary obligations because the government is concerned about those few taxpayers who may use the restorative payment process as a way to make improper contributions to their plans. There is no way to prevent abuses any more than there is a way to prevent prohibited transactions or violations of the qualification, funding or other requirements. However, that doesn't mean that the IRS and Treasury should avoid issuing guidance. Indeed, it makes the necessity for clear and detailed guidance all the more important along with an active and effective audit program to measure and monitor compliance. To that end, we suggest the following:

- Requiring plan sponsors or fiduciaries who make restorative payments to a qualified plan to notify the IRS by making a simple written filing to the IRS and/or DOL;
- At such time in the future when the Form 5500 is again modified, the required disclosure could be added as an item to that form. In either case, the disclosure should consist of notification that the restoration payment was made, the dollar amount of the payment and the general circumstance under which it was made, e.g., as a result of a DOL investigation, participant lawsuit, settlement of claims not yet manifested in a lawsuit, etc.;
- The IRS could expand its examination guidelines to provide its field personnel with greater guidance concerning the examination of plans for possible abuses of Code sections 404, 415, 4972, etc.

### **What, if any, guidance should be given to plan sponsors regarding the calculations of lost opportunity costs?**

ASPPA believes that the various principles and guidance which have already been issued with respect to the correction of fiduciary breaches and the correction of operational failures in qualified retirement plans should be sufficient guidance for plan sponsors and fiduciaries to calculate lost opportunity costs. In particular, we note the guidance on earnings calculations contained in the recently issued Rev. Proc. 99-31, which could serve as the guidance on earnings calculations in this area as well. The fundamental principle involved is the requirement that the correction place the affected participants and their beneficiaries in the position they would have been had there been no breach of fiduciary duty. With this said, ASPPA believes that it is of practical importance for the IRS to continue to allow plan sponsors the flexibility to utilize methods of calculating "lost earnings" that are appropriate under the facts and circumstances of a particular situation.

The members of ASPPA and their clients do not believe it is important for the IRS to issue detailed guidance as to exactly how to calculate or determine lost opportunity costs. What is important is for the IRS to issue guidance that it is appropriate under certain circumstances to make restorative payments that are fair to participants and which will not be treated as annual additions.

### **What happens if a restorative payment situation involves a prohibited transaction?**

ASPPA is aware of a number of private letter ruling requests which required the applicant to make separate application to the DOL for a prohibited transaction exemption (PTE) because of the nature of the restorative payment. Generally, these requests involved situations in which the plan sponsor had agreed to make the plan

whole for a recognized fiduciary breach subject to the ability of the plan sponsor to receive reimbursement based on the results of pending or proposed litigation involving a third party or a recovery based upon the ultimate disposition of a hard-to-value asset. In light of the overlapping jurisdictions of the IRS and the DOL with regard to these matters, ASPPA recommends that Treasury and the IRS focus primarily on the aspects of restorative payments for which Treasury and the IRS have jurisdiction and leave it up to the affected plan sponsors and/or fiduciaries to determine whether or not they must also obtain the approval of DOL for their proposed restorative payment. We believe any attempt at this time to develop a comprehensive set of rules which address the overlapping jurisdictions of IRS and DOL with respect to such matters, would unnecessarily delay the issuance of much needed guidance.

Although Ms. Null indicated that Treasury might be somewhat reluctant at this time to issue a revenue ruling as recommended in ASPPA's letter, we nonetheless believe that such a ruling and such guidance would now be appropriate. Based upon our discussions with numerous other ASPPA members, we are convinced that the practice of making restorative payments has grown considerably in recent years (particularly in response to the availability of the numerous private letter rulings that have now become public on this issue). We feel that it is important for Treasury and IRS to provide guidance to other taxpayers so that they too can make corrections of fiduciary breaches that benefit all the participants of their plan in accordance with any technical requirements which Treasury and the IRS may impose on such corrections. Such guidance would also enable taxpayers to make the correction properly without being required to apply for a private letter ruling, which could delay (and possibly in some cases even eliminate) voluntary correction. Although we recognize there is potential for abuse in this area, we feel that the potential for abuse is no greater and no more likely than with respect to the basic contribution and allocation limits set forth in Code sections 404 and 415. If an unscrupulous taxpayer wishes to attempt to contribute more money to its plan than is proper, there are much easier ways than to structure the excessive payment as a restorative payment.

We hope that this letter has been helpful and has addressed some of the issues raised in the earlier conference call. ASPPA would appreciate the opportunity to engage your office in further discussions on how guidance of this type can be developed and issued as soon as possible.

If you have any questions with regard to this matter, please feel free to address them to any of the undersigned.

Very truly yours,

Jeffrey C. Chang, Chair  
IRS Enforcement Subcommittee

Craig Hoffman, Co-Chair  
ASPPA Government Affairs Committee

Bruce Ashton, APM, Co-Chair  
ASPPA Government Affairs Committee

Brian Graff, Esq.  
ASPPA Executive Director

R. Bradford Huss, APM, Chair  
ASPPA Administration Relations Committee

Mike Canan, Chair  
Department of Labor Subcommittee

JCC/clm  
cc: Amy Null, Esq.