



AMERICAN ACADEMY *of* ACTUARIES

Internal Revenue Service
CC:PA:LPD:PR (REG-108508-08), Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

July 15, 2008

Re: Regulations on Determination of Minimum Required Pension Contributions (REG-108508-08)

To Whom It May Concern:

On behalf of the American Academy of Actuaries¹ Pension Committee, we respectfully request your consideration of our comments regarding the proposed regulations on the Determination of Minimum Required Pension Contributions (REG-108508-08). The proposed regulations provide much needed guidance regarding the new contribution rules in the Pension Protection Act of 2006 (PPA). The primary focus of our comments pertain to the means by which the carryover and prefunding balances may be used to satisfy quarterly contribution requirements.

Need for flexibility

The proposed regulations would require an explicit election to apply any funding balance by the quarterly payment due date. It appears the election would be for a specific amount, and be irrevocable. Proposed regulation 1.430(j)-1(c)(1)(ii) states:

(ii) Satisfaction of installments through use of funding balances. In the case of a plan that is subject to the quarterly contribution requirement under this paragraph (c), if the plan sponsor makes an election to use the plan's prefunding balance or funding standard carryover balance *under section 430(f)*, then the plan sponsor is treated as satisfying the obligation to make a required installment under paragraph (c)(1)(i) of this section *on the date of the election to the extent of the amount elected...* [Emphasis added]

And proposed regulations 1.430(f)-1(f)(1 and 3) state:

(f) Elections--(1) Method of making elections. Any election under this section by the plan sponsor must be made by providing written notification of the election to the plan's enrolled actuary and the plan administrator. The written notification must set forth the relevant details of the election, *including the specific amounts* involved

¹ The American Academy of Actuaries is a 16,000-member professional association whose mission is to assist public policymakers by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

in the election with respect to the prefunding balance and funding standard carryover balance...

(3) Irrevocability of elections. A plan sponsor's election under this section with respect to the plan's funding standard carryover balance or prefunding balance is *irrevocable (and must be unconditional)*. [Emphasis added]

Fortunately, the preamble contemplates "whether rules should be provided under which a plan sponsor is deemed to make an election to use a funding balance to the extent it is available to avoid a failure to make any required quarterly installment ["deemed election"] or under which a plan sponsor can make a single election that will apply to all future quarterly installments until revoked ["evergreen election"]". We strongly support additional flexibility such as is contemplated in the preamble, as opposed to the proposed regulations' explicit election approach.

Quarterly contribution requirements are generally based on the lesser of the prior year minimum or 90 percent of the current-year minimum. Thus, for example, as of the April 15 due date for the first quarterly contribution for a calendar year plan, the actual amount of quarterly required will likely be unknown, as the current year valuation will likely not have been completed. Accordingly, final regulations should reflect that the decision to apply a funding balance to satisfy the quarterly requirement will often be made without knowing the exact amount of funding balance needed.

In fact, there are realistic situations where an explicit election of a specified dollar amount, based on an estimated quarterly, could prove to be impermissible under the statute. Consider the case of a frozen plan. As of April 15, 2008, a quarterly is estimated based on 2007 valuation results. In early September 2008, a 2007 plan year contribution is made that elevates the funded status above 92 percent. In this case, suddenly the minimum required contribution for 2008, and therefore the quarterly that was required as of April 15, 2008, drops to zero. Yet Internal Revenue Code (IRC) Section 430(f)(3)(A), as added by PPA, states:

Except as provided in subparagraphs (B) and (C), in the case of any plan year in which the plan sponsor elects to credit against the minimum required contribution for the current plan year all or a portion of the prefunding balance or the funding standard carryover balance for the current plan year (*not in excess of such minimum required contribution*), the minimum required contribution for the plan year shall be reduced as of the first day of the plan year by the amount so credited by the plan sponsor as of the first day of the plan year. For purposes of the preceding sentence, the minimum required contribution shall be determined after taking into account any waiver under section 412(c). [Emphasis added]

Thus, it seems the statute prohibits any election to use more of a funding balance than the amount of the minimum required contribution, again emphasizing the need for the final regulations to provide flexibility with respect to the amount elected or with respect to the timing of the election.

Alternatives

In August 2007, the IRS proposed guidance on elections to apply funding balances. Proposed regulation 1.430(f)-1(f)(2) states:

(2) Timing of elections--(i) General rule. Except as provided in paragraph (f)(2)(ii) of this section, any election under this section must be made on or before the due date (with extensions) for the filing of the plan's Form 5500 "Annual Return/Report of Employee Benefit Plan" for the plan year to which the election relates (or, in the case of a plan not required to file a Form 5500 for the plan year, on or before the last day of the seventh month after the end of the plan year to which the election relates).

We believe this rule should apply not just to the minimum required contribution as a whole, but to quarterlies as well. That is, timing of elections to use funding balances, including those intended to cover quarterly contributions, only need to be made before the Form 5500 filing date for the relevant plan year.

While we believe the structure already proposed in the 430(f) regulations should be suitable for quarterly purposes, the "deemed" or "evergreen" election alternatives, as contemplated in the preamble, would have a similar effect and would be preferable over the explicit election approach proposed in the 430(j) regulations.

The "deemed" or "evergreen" election alternatives described in the preamble raise the issue that the amount of the funding balances used, and thus the amount of the funding balances remaining, may not be known for a while after the quarterly contribution due date.

We recognize that this might make it difficult to determine whether an election to reduce funding balances is possible for purposes of section 436. In addition, a deemed election to reduce funding balances is required in certain cases if such reduction would be sufficient to enable the AFTAP to reach 60 percent or 80 percent.

However, this issue applies to relatively few plans, compared to the quarterly contributions that apply to most plans. Furthermore, given the timing issues, we think few practical problems would be created. A deemed waiver would generally occur only at the start of the fourth month—which is before the first quarterly installment for the current year is due—or at the specific AFTAP certification date, when the actual amount of quarterly installments will be known.

If the IRS is nonetheless concerned about applying deemed-waiver rules, then for section 436 purposes, whenever a "deemed" or "evergreen" election is in effect, it could be assumed that the amount of funding balance that has been used is equal to the preliminary required quarterly contribution payments based on the prior year's minimum required contribution. If it is subsequently determined that the current year's minimum required contribution yields lower required quarterly contribution payments, then the deemed

waiver would be redetermined. This would be treated as an immaterial change, similar to an election to reduce funding balances that occurs after an AFTAP certification.

Under the structure proposed in the 430(f) regulations, an election is allowed until the due date for the filing of the plan's Form 5500. However, if an election to use funding balances is delayed past a quarterly contribution date and not made before the AFTAP certification, then the entire amount of the funding balances is available for voluntary or deemed reduction. This allows a plan sponsor to reduce the funding balances to avoid a 436 restriction even if the remaining funding balances are insufficient to use for the prior quarterly contribution, which could result in a missed quarterly contribution. Thus, the sponsor is responsible for coordinating elections for using and reducing funding balances.

Reasonable interpretation for 2008

We also ask the IRS to confirm, either through final regulations or other guidance, that plan sponsors may rely upon a reasonable interpretation of the statute for 2008 for this quarterly/funding balance purpose. Similar guidance was provided in Notice 2008-21, but its application to this situation is not clear. Particularly given the late release of the 430(j) proposed regulations, the fact that they are effective for 2009 plan years, the existing words of the 430(f) proposed regulations as cited above, and past practice with respect to applying credit balances to quarterlies without an explicit election, plan sponsors who did not make explicit elections during 2008 should not be penalized, even if the regulations as proposed were to be finalized with the explicit election requirement.

Excess contributions that can be added to the prefunding balance

The preamble to the proposed regulation states:

Plan sponsors should also note that, pursuant to proposed §1.430(f)-1(b)(1)(ii)(B), the amount of the funding balance that is used to satisfy the quarterly contribution requirements cannot later be added back to the prefunding balance (because only contributions in excess of the minimum funding requirement, determined without regard to the offset under section 430(f)(3), are eligible to be added to the prefunding balance).

We are concerned that this interpretation of the statute will create an incentive for plan sponsors to defer contributions until the following year, rather than in the current year. This would encourage plan sponsors to delay contributions, when clearly the intent of PPA is to accelerate and improve funding.

For example, suppose the minimum contribution, without regard to any funding balances, is \$100 and quarterly contributions are \$20 each (because \$80 is the prior-year minimum). The sponsor uses \$40 of carryover balance (for simplicity, ignoring interest) to pay the first two quarterlies, and then decides it has the ability to pay the full \$100 minimum contribution. This decision is too late to save the carryover balance as the sponsor has already irrevocably used \$40 of carryover balance. Under the proposed regulations, the

sponsor also cannot add anything to the prefunding balance, since only contributions in excess of \$100 (the minimum contribution before offset by funding balances) can be added to the prefunding balance. Thus, in the case where the sponsor is considering a contribution of more than \$60, it will be advantageous to contribute just \$60 in the current year and to wait until the following year to pay the additional contributions.

IRC Section 430(f)(6)(B)(i)(II) does not specifically state that the excess is determined without considering funding balances applied against the minimum contribution; the Code simply refers to the “minimum required contribution.” For this purpose, to avoid an incentive to delay contributions, this should be determined *after* applying funding balances against the minimum contribution. This would be consistent with IRC Section 430(f)(3)(A), which states that, when funding balances are credited, “the minimum required contribution for the plan year shall be reduced... by the amount so credited”.

Alternatively, if excess contributions are determined without regard to funding balances applied against the minimum contribution, then the following should be considered. Under the authority of IRC Section 430(f)(9), regulations could specify that for the purpose of quarterly contributions, sponsors are deemed to make a tentative election to use funding balances to the extent necessary to avoid late contributions. If a sponsor later decides to pay actual contributions instead of using funding balances, clearly the intent of the law is that this be viewed positively, as it puts the plan in a better-funded position than if the funding balances were used. Thus, a tentative or deemed election to use the funding balances should be able to be revoked without late contribution penalties and with the funding balances restored.

We thank you for this opportunity to share our thoughts on these proposed regulations. We would be interested in meeting with you to answer any questions or discuss any of the concerns expressed in this letter. If a hearing is held regarding this regulation the Pension Committee would appreciate an opportunity to testify. Should you have any specific questions or would like more information, please contact Samuel Genson, the American Academy of Actuaries’ pension policy analyst, at 202-223-8196. Thank you for your consideration of this matter.

Sincerely,

James F. Verlautz, FSA, EA, MAAA, FCA
Chair, Pension Committee
American Academy of Actuaries