



SOCIETY OF ACTUARIES

Intersector Group report to the Society of Actuaries'¹ Pension Section Council

Meeting with the
Internal Revenue Service/Treasury
March 13, 2013

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¹ The Society of Actuaries is an educational, research and professional organization dedicated to serving the public and Society members. The SOA's vision is for actuaries to be the leading professionals in the measurement and management of risk.

**Notes from Intersector Meeting with IRS/Treasury
Wednesday March 13, 2013**

The Intersector Group is composed of two delegates from each of the following actuarial organizations: American Academy of Actuaries, Society of Actuaries, Conference of Consulting Actuaries, and ASPPA College of Pension Actuaries. Twice a year the Intersector Group meets with representatives of the U.S. Department of Treasury (Treasury Department) and the Internal Revenue Service (IRS) to dialogue with them on regulatory and other issues affecting pension practice. The following individuals participated in the March 13, 2013, meeting with the IRS and the Treasury Department: Tom Finnegan, Don Fuerst, Alan Glickstein, Eli Greenblum, Judy Miller, Heidi Rackley, Larry Sher, and Sarah Wright. David Goldfarb, Academy staff member supporting the Intersector Group, also attended.

These meeting notes are not official statements of the Treasury Department or the IRS and have not been reviewed by its representatives who attended the meetings. The notes merely reflect the Intersector Group's understanding of Treasury Department/IRS representatives' views expressed at the meeting, and are not to be construed in any way as establishing official positions of the Treasury Department, the IRS, or any other government agency. The notes cannot be relied upon by any person for any purpose. Moreover, the Treasury Department and the IRS have not in any way approved these notes or reviewed them to determine whether the statements herein are accurate or complete.

1. Proposed date for next meeting: September 11, 2013
2. Update from IRS/Treasury:

They are working hard to get guidance out, and are hopeful that some guidance will be issued between now and the EA meeting or the ABA meeting in May. However, no details were offered as to what specific guidance would likely be out next, and we were cautioned not to expect all of the projects we know they are working on to be out by June 30. Next year's work plan will likely include guidance on 404 and mortality tables (see item 12). IRS will be soliciting input on next year's work plan in April.

3. How are failures to start benefits when participants working beyond the April 1 following their 70-1/2 year reach the 415 compensation limit (so they cannot receive further required actuarial increases) corrected? Any participant who works long enough will eventually run up against the compensation limit, regardless of the participant's compensation level. With the compensation limit and additional accruals both potentially changing over the plan year, it is often impossible to predict in advance when the cross-over will occur, so sponsors are often in the position of having to start benefits retroactively. We presume sponsors can self-correct under EPCRS using an approach similar to that used to correct failures to start benefits at the required beginning date – paying back payments with interest. We would like to confirm this is the correct approach.

We also have a related concern as to whether benefits must start when there is a “temporary” cross over in the middle of a plan year. This can happen because the required actuarial increase (and additional accruals under the plan formula, depending on the plan design) may occur throughout the year, but the 415 compensation limit may be constant until late in the year when the participant’s year-to-date compensation exceeds their compensation for the third preceding year. This can lead to a situation where the compensation limit would have limited the participant’s benefit if the participant had terminated in October, but does not limit the benefit at year-end. Do sponsors need to check the benefit against the 415 compensation limit each month? Or is it sufficient to check annually at plan year-end, and start benefits only if the 415 compensation limit constrains the benefit at plan year-end?

Response: Assuming the plan provides that payments are to begin before hitting the 415 limit, a correction can be made under EPCRS by making back payments. The back payments are not counted toward 415 for the year actually paid, but for the year they should have been paid, so no 415 violation.

There is no firm answer on month-to-month. The administrator must have procedures to monitor 415 with reasonable frequency, but every month probably is not necessary.

4. Can a 401(k) plan ever hold “frozen” Roth accounts? Consider the following situations:
 - a. A 401(k) plan adds a Roth feature. After two years, the sponsor finds that only 2% of covered employees are making Roth contributions and the feature has substantially increased ongoing administration and communication costs. The sponsor would like to prospectively eliminate the Roth feature, maintaining frozen Roth accounts for those participants who have taken advantage of the feature, but not accepting future Roth contributions.
 - b. Company A’s 401(k) plan does not permit Roth contributions; Company B’s plan does. A buys Division X from B. B would like to transfer the 401(k) accounts of Division X employees to A’s 401(k) plan in a plan-to-plan transfer. A does not want to add a Roth feature but is willing to maintain frozen Roth accounts for employees transferring from Division X. Can A’s plan accept a plan-to-plan transfer from B if any Division X employees have Roth accounts?
 - c. The facts are similar to situation (b.), except there will be no plan-to-plan transfer. Division X employees can request cash distributions or leave their 401(k) accounts in B’s plan. A would like to offer Division X employees the option of rolling over their accounts to A’s 401(k) plan so they can consolidate their retirement savings. Can A’s plan accept a rollover from a Division X employee with a frozen Roth account?

Some major 401(k) service providers are treating these three situations differently, allowing frozen Roth accounts in situations (a.) and (b.), but refusing to accept rollovers from participants with Roth accounts in situation (c.). They point to language in the preamble to the final regulations on Roth distributions and rollovers

(http://www.irs.gov/irb/2007-22_IRB/ar07.html). The fourth paragraph under “Rollover of Designated Roth Contributions” says:

“In response to comments, the definition of designated Roth account has been revised to clarify that the definition only includes accounts under a plan to which designated Roth contributions are made in lieu of elective contributions or deferrals. Thus, the final regulations clarify that a distribution from a designated Roth account may only be rolled over to a section 401(k) plan or section 403(b) plan if that has a designated Roth program.”

But it is difficult to find a rationale within the regulations for treating the three situations differently since the definition of “designated Roth account” comes into play in all three cases. Reg. Section 1.402A-1 Q1 and 1.401(k)-1(f)(4)(ii) define a designated Roth account as “a separate account to which designated Roth contributions are permitted to be made in lieu of elective contributions.” This could be interpreted as requiring any plan that holds Roth contributions to accept ongoing Roth contributions, raising the concern that, if situation (c.) violates the regulations, situations (a.) and (b.) might also violate them.

Response: It is ok to stop future Roth contributions, so a. is ok. Situation c. is clearly a problem – there can be no rollovers if there is not an existing designated Roth account. No answer on b.

5. Rev. Proc. 2013-12 has triggered a couple questions:

- a. Section 6.02(4)(d), clarified the actuarial equivalence factors that should be used to determine a corrective distribution from a defined benefit plan. When a plan's provision for actuarial equivalence includes a specified mortality table, should a corrective distribution in the form of a make-up payment (as opposed to actuarially increased future annuity payments) be adjusted for survivorship as well as interest, even though there presumably was no risk of forfeiture on death? For example, suppose a participant received a lump sum distribution. A year later, the sponsor discovers that a benefit calculation error was made and the distribution should have been \$1,000 higher. The plan needs to correct the underpayment regardless of whether the participant is still living at the date of the make-up payment, so it would not seem to be appropriate to accumulate the \$1,000 with both interest and survivorship. Does the answer depend on the plan wording? That is, would the answer be different depending on whether the plan specifies "Actuarial equivalence shall be determined using 5% interest and the 417(e)(3) mortality table." versus "Actuarial equivalence shall be determined using 5% interest and, for periods when benefits would be forfeited upon the participant's death, the 417(e)(3) mortality table."

Response: It depends on the situation. If payment is just a few months late, interest only is fine. If it's more than a few months late, follow the plan terms. If the plan's provisions are not clear, or give the plan administrator discretion, the

methodology used for determining corrective distributions should be consistent with the interpretation applied for other purposes. For example, if late retirement increase factors reflect both interest and survivorship even though the plan pays the full value of the accrued benefit upon death, then it may be consistent to adjust corrective distributions for mortality even when there is no risk of forfeiture on death.

- b. Section 6.06(3) (via 6.02(4)(e)), says that 436(d) overpayments can be corrected using the Return of Overpayment or Adjustment of Future Payments correction methods. If a 50% lump sum was paid out erroneously while full restrictions were in place, would a correction utilizing the Adjustment of Future Payments method allow leaving the overpaid LS payment intact with an implicit reduction of future payments to correct for the overpayment?

Response: The adjustment of future payments method is a secondary method at best. First, the plan administrator must try to recover the overpayment. If recovery has been attempted, and the annuity payments commence immediately, then adjustment of future payments is reasonable, but if the annuity portion is deferred for a long period, the employer needs to make the plan whole. In any event, if the participant does not return the overpayment (other than by reduction of future payments), the participant must be notified that the overpayment is taxable, and is not subject to rollover.

6. Suppose a plan comes out of 50% restriction on lump sums. Half the benefit was previously paid as an annuity, and now a lump sum is elected for that. How is remaining lump sum calculated?

Response: The approach in last year's PLRs on offering lump sums to retirees in pay status might make sense. IRS is still working through a number of 417(e) issues. For example, if the plan's lump sum is based on the normal retirement annuity and the early retirement annuity is more than would be determined using 417(e) rates, does a second lump sum need to be topped up to reflect the early retirement subsidy? Or on the flip side, if the early retirement is less than would be determined using 417(e) rates, is paying the present value of remaining payments sufficient to satisfy 417(e) minimum present value rules? They haven't worked through the details of how an early retirement subsidy would be considered and guidance for this situation is not in the current guidance plan. If this is an important issue, request that it be included in next year's work plan.

7. Some plans have moved to variable (typically 417(e)) assumptions for all plan purposes, including actuarial increases for late retirement. Since the 417(e) assumptions change annually, are there restrictions on the assumptions that should be used in the late retirement actuarial increase calculation? May a plan provide that the 417(e) assumptions in effect on the actual benefit commencement date are used for all purposes, including the late retirement increase (even though this might produce a smaller benefit than would have been determined using the assumptions in effect at the end of the prior plan year)?

Or must the plan use the assumptions that were in effect for each plan year for which an actuarial increase is provided (and if so, why)?

Response: They have not thought about it but offered the following issues to consider. Need to be concerned about forfeitures, and also 411(b)(1)(G) (that the benefit cannot decrease on account of increasing service). Thus, for a calendar-year plan, the benefit payable 1/1 cannot be less than the benefit payable 12/31 using last year's factors if the change is on account of service. If the benefit could have been deferred into the next year if the employee had terminated earlier, then the reduction may not be on account of additional service. But if the plan would have required the benefit to start in the earlier year if the employee had terminated earlier, then the reduction seemingly would be on account of service. This issue comes up for actuarial increases from April 1 following the participant's 70½ year since terminated participants must start benefits by that date. For plans that require terminated participants to start benefits at NRD, this is an issue for all late retirement increases.

8. Deductibility of contribution needed to fully fund plan upon standard termination. IRC §404(o)(5) provides that the amount needed to make a plan sufficient for benefit liabilities is deductible in the year that the plan terminates. The termination process can easily span two or more plan years, especially if the sponsor is waiting for a favorable determination letter. To avoid the potential for creating surplus assets, plan sponsors typically want to delay funding until close to the time benefits will be distributed. Does the §404(o)(5) deduction limit continue to apply after the plan's termination date? (The IRS is passing on this for the Gray Book and I know we've gotten into this in the past but...)

Response: No answer, though they are well aware of the problem. They suggested we ask them to add it to the guidance plan, since 404 is expected to be on it next year. No one present knew of a company that had deducted the full amount after the year of termination and had a problem on audit. If a sponsor deducts a contribution made to make plan assets sufficient upon termination and the deduction is denied on audit, then IRS would be forced to deal with the issue sooner.

9. Minimum Age and Service Requirements: A profit sharing plan divides participants into three categories:
1. Those under age 35
 2. Those at least 35 but less than 50
 3. Those at least age 50
- a. Can the employer make contributions for only group 3 or only groups 2 and 3 without creating an impermissible service requirement under 410(a)?
- b. A profit sharing plan freezes contributions for participants under age 50, and continues contributions for participants age 50 and over. Is this an impermissible age requirement since a participant must be at least 50 years old to benefit?

If the answer is no, would the answer be different if participants resumed contribution eligibility upon attaining age 50?

Would the answers be different if this was a defined benefit plan?

Response: The immediate response was that, with respect to (a.), there is clearly a problem – the grouping is essentially an age requirement. Asked if the answer would be different if all groups get contributions in many years, but in some years group 1 or group 2 (or groups 1 and 2) get \$0 while group 3 gets an allocation, IRS allowed that it might be okay, provided the plan passes nondiscrimination rules every year. (IRS did not appear comfortable with that answer, however and hadn't yet thought it through.)

With respect to b., grandfathered groups based on attained age at a specified date (e.g., age 50 at Jan. 1, 2013) are allowed as long as the plan passes discrimination testing. But if this is a dynamic grandfather (e.g., anyone employed on Jan. 1, 2013, gets a contribution once they attain age 50), this is a problem. If plan was DB, it would have to pass accrual rules, which would be a problem if there was a dynamic grandfather.

10. 417(e) rates - lump sums and administrative delay: Assume lump sum due for Calendar Year plan is calculated and QJSA Notice sent to participant in November 2013 assuming an ASD of December 31, 2013. Plan has an annual stability period.

Participant and spouse execute and return forms in December, but distribution is not made until January 15, 2014.

Should distribution be based on 417(e) rates for 2013 or 2014? If 2014, must the QJSA notice be updated to reflect the benefits payable using those rates? What constitutes a reasonable administrative delay?

Assume same facts, but that the election is not returned until January, followed by distribution, should it be based on 2013 or 2014 rates?

Response: The ASD determines the assumptions to be used. The statute says if the form is a LS distribution, the ASD is the date “all events have occurred which entitle the participant to such a benefit”, which would include return of signed forms. (This is not stated in the reg.) Thus if forms are signed and returned in December, and distribution is made in a reasonable period, 2013 assumptions should be used. If the forms are signed and returned in January, the ASD is in January and the 2014 rates must be used. Because the relative benefit amounts will have changed, new QJSA forms should be issued with the amounts based on 2014 rates. In this situation, it makes sense to clearly note on the election forms that the amounts shown on the form are only good if the forms are signed and returned by the end of the year. (“Reasonable administrative delay” is not going to be defined.)

11. What is the current turn-around time on requests for change in funding methods or changes in assumptions? Is the turn-around time different for requests in connection with plan mergers than for other requests?

Response: It depends on the situation – M&As take longer – but generally 3-6 months. They are taking notes as they go with a revision of 2000-41 in mind. Also 2000-40, but with the understanding that the current procedure has to be retained for plans with delayed PPA effective dates and Multiemployer plans. We should let them know what we want on the revisions list.

12. When do you expect to publish mortality tables (for both 417(e)(3) and 430 purposes) for 2014? Is the timing tied to publication of new SOA mortality tables (according to BB report, expected late 2013 or early 2014)?

Response: Expect this on next year's business plan. They are leaning toward issuing mortality tables for 2014 and 2015 "soon," and perhaps providing guidance for a longer period later after the new SOA tables are out. Asked when this was needed, we said 417(e) is the biggest driver, and it is needed by July. It was also noted that they have not committed to going to scale BB.

13. Access to just-released guidance. Certain entities are getting access to and posting new IRS guidance on their websites even before the documents are posted on the IRS drop site (<http://www.irs.gov/pub/irs-drop/>) or released through Guidewire. Rather disconcertingly, the "document properties" often show the author is "Mom Laptop" rather than "Internal Revenue Service" raising questions as to the document's authenticity. How are these entities obtaining these documents? How can the rest of us join this select group receiving these materials through special channels?

Response: They will look into this. Media are typically given access before the general public, and that is something they will look into. At the EA Meeting Dialogue session, they will provide information on who gets what when, where guidance can be accessed, and what mailing lists are available.

14. Timeliness of covered compensation table publication -- The information required to determine the following calendar year's covered compensation tables is available when SSA announces the wage base in mid-October, yet the 2013 covered compensation tables weren't released until February 8, 2013. Service providers for plans using covered compensation in their benefit formulas would like to have the official announcement much earlier -- in time to use in updating their benefit calculation programs. While actuarial firms have software to calculate these tables, sponsors are reluctant to use "unofficial" values and those using the rounded table are concerned IRS might decide to change the rounding rules given the rounded table isn't much shorter or simpler than the unrounded table these days. Can the publication process be speeded up? We realize Rev. Ruls. go through more layers of review, but would it be possible to include covered compensation tables in the IRS news release with retirement plan limits that you've been

publishing the same day SSA announces the next year's wage base, then publish the Rev. Rul. later?

Response: They should be able to get future tables out earlier than the 2013 ones, probably in December, but will not be able to get them out at the same time as the COLAs.

15. Is a plan amendment permitting vested participants to receive in-service distributions at age 62 – with no change in the benefit formula, accrual rate, or vesting schedule – subject to 436 restrictions if, due to an associated change in the expected age when distributions start, the funding target increases?

Response: The availability of a distribution at age 62 is a new benefit, and per 1.436-1(c)(1) would be an amendment increasing benefits. So yes, 436 restrictions would apply. Asked if simply updating early retirement factors would fall in this category, IRS/Treasury said the change would only be excluded if the prior factors were no longer reasonable and thus the change was required to maintain the plan's qualified status.

16. A company sponsoring three pension plans elected PRA 2010 relief for all three plans in 2011. After enactment of MAP-21, one of the plans is overfunded and eliminates all amortization bases in 2012. We presume that plan should be ignored in allocating 2012 (and later) excess compensation among the plans electing relief. Please confirm.

Response: That makes sense.