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

Meeting with the Internal Revenue Service/Treasury April 4, 2018

[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.

Intersector Group Meeting with the U.S. Department of Treasury and Internal Revenue Service Notes

April 4, 2018

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 discuss regulatory and other issues affecting pension practice. The Intersector Group is composed of two delegates from each of the following actuarial organizations: American Academy of Actuaries (Academy), Conference of Consulting Actuaries (CCA), Society of Actuaries (SOA), and ASPPA College of Pension Actuaries (ACOPA). Attending from the Intersector Group at this meeting were Bruce Cadenhead (CCA), Tom Finnegan (ACOPA), Ted Goldman (Academy), Eric Keener (SOA), Tonya Manning (CCA), John Markley (ACOPA), Maria Sarli (SOA), and Jason Russell (Academy). Monica Konaté, the 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 their representatives who attended the meeting. 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.

The discussion topics shown in regular typeface were submitted to the IRS in advance of the meeting. The comments by representatives of the Treasury and IRS are in italics.

Part I: Questions From the Profession

- Guidance Process—*The timing for future guidance is unpredictable, as the agency's top priority is implementing tax reform. All guidance has to go through a lengthy process that includes chief counsel, deputy commissioner, and office of tax counsel. Non-tax-reform projects will have to be prioritized and some of these will have to wait until after tax reform is implemented. The agency is interested in input from the profession on which areas should have highest priority. The agency is also encouraging practitioners to continue to raise issues so that it can make sure the priorities are on the list of things for consideration. Additionally, a suggestion was made that it would be* *helpful for the Intersector Group to put together an inventory of the issues that the group thinks need to be addressed.*

- Cash balance/hybrid plan issues—will there be any further guidance? For example, is the agency considering guidance on the following topics:

    - Plans that are not lump-sum-based because the plan provides subsidized annuities at normal retirement date (NRD) (or that might have subsidies at some times and not at others, such as plans with flat factors) and how such plans might be able to become lump-sum-based?
    - The IRS requested comments on implicit interest pension equity plans (PEPs), suggesting the possibility that guidance may be issued that reverses the position expressed in Notice 2016-67 saying that implicit interest PEPs are not subject to market rate rules under the current regulations. Is this now a settled issue (that is, they are not subject to the market rate rules), or is the topic still under review?

    The IRS/Treasury representatives indicated that they have been considering issues related to hybrid plans as people continue to raise them. The agency is looking into these two issues, as well as the question about which rate to use to project hybrid plan benefits for purposes such as nondiscrimination testing, accrual rules, and calculating 415 limits. In addition, the agency is trying to identify other subsidiary issues that come up because very old regulations must be applied to hybrid designs, but these designs did not exist when the regulations were written. For example, the top-heavy regulations are very outdated.

    The agency intends to provide guidance either way on PEPs—whether confirming the guidance in the earlier notice or taking a different position. In addition, it may provide relief to those who have amended hybrid plans in a manner inconsistent with subsequent guidance.

    The Intersector Group expressed the opinion that these hybrid plan issues are likely higher priority than many of the other issues discussed, but that the level of urgency is dependent on whether the guidance, once issued, will have retroactive application. If so, then it becomes much more important to get the guidance sooner, rather than later.

- The IRS priority guidance plan updated in February 2018 indicates that the agency is working on guidance regarding missing participants. What issues is this guidance likely to address? How is the IRS coordinating with the Department of Labor (DOL) and the Pension Benefit Guaranty Corporation (PBGC) on these issues and its anticipated guidance?

    The IRS/Treasury representatives noted that the IRS is consulting with DOL and PBGC on this issue. The IRS understands the need to avoid requirements that could conflict with DOL or PBGC standards (e.g., on fiduciary duties, or plan termination requirements). Comprehensive guidance will likely take a while due to the need to coordinate. In the meantime, the IRS may move forward on some issues that can be addressed *independent of DOL/PBGC concerns. Uncashed checks for participants who are not actually missing is a known issue.*

Some members of the Intersector Group commented that the issue of uncashed checks can be very important. Third-party administrators often treat the check as being paid once it is issued and do not necessarily report back to the sponsor those that have not been cashed. The money typically does not remain in the plan trust, but rather in a clearing account. One question is whether these funds are subject to escheat laws.

There was also a discussion of sponsor challenges relating to what constitutes an appropriate reasonable search. These include:

- When do you need to use a paid search provider vs. a "free" internet search, given that the paid searches may be costly due to the time required?
- What is an acceptable frequency of searches that would be both practical and effective?
- What are acceptable practices that have been most successful in meeting requirements?
- What are possible remedies when the sponsor cannot locate a surviving spouse or other beneficiary when the participant is known to have died?

- Nondiscrimination testing—the House tax bill (which did not pass) had a provision to include IRC section 401(a)(26) relief for frozen defined benefit (DB) Plans. Has the IRS determined that legislative action is the only remedy?

  The IRS/Treasury representatives expressed concerns about whether the agency has the statutory authority to provide this relief or whether legislative action is required. The agency is considering the comments it received on the proposed regulations that suggested how this issue might be addressed from a regulatory perspective, and have not conclusively ruled that approach out.

- Approval for change in funding method—what has been the experience to-date? In the change in actuary (takeover) situation, if the new actuary is using the same software, is there still a change in method due to the takeover that must be approved?

  IRS/Treasury representatives indicated that the volume of method change requests is similar in the most recent year to what it had been in the previous year. Requests relating to spinoffs are becoming more common. Some of the requests are not clear about the change for which approval is being requested. It will facilitate review if the request highlights what exactly is changing (i.e., what calculations, methods, or transition approaches the IRS is being asked to approve) and shows results both before and after the change. It would be helpful to summarize the situation for the IRS (e.g., "we are following the Rev. Proc. procedures for automatic approval for this merger but the merger does not qualify for automatic approval because the AFTAPs are in different ranges, or one plan had a funding shortfall and the other did not.").

The Intersector group pointed out that in many cases it is not clear whether a method change has even occurred. Specifically:

- When does a spinoff/merger result in a method change?
- Does a change in actuary and actuarial firm always constitute a change in method?
- In some situations, it is not clear what constitutes a data element and therefore what constitutes a change in data element. For example, would there be a change in data elements, and therefore a change in funding method, if the sponsor of a frozen plan finalizes the accrued benefits for all of the plan's participants? For some of the participants? When do you cross the line to a method change?

IRS/Treasury representatives are aware that there is continued uncertainty about what constitutes a method change. A change in both actuary and actuarial firm always constitutes a method change unless the new actuary/firm gets the exact same values, which almost never happens (and of course automatic approval is available when the change is not large). The IRS is actively engaged on the issue of mergers and spinoffs. Even if ongoing methods are not changing, the IRS is interested in the transition approach employed. As the agency reviews more requests involving mergers and spinoffs and other issues that come up on approval requests, more guidance and automatic approvals are likely to be added.

There was some discussion about whether replacing data estimates with actual data constitutes a method change—particularly in a plan termination situation. Rev. Proc. 2017-57 states:

> *"However, if actual data generally was used for the prior plan year except that assumed data was used to fill in for some data that was missing or incomplete, then the use of actual data for the current plan year (because there is no longer a need to fill in for missing or incomplete data) would not be a change in the selection of data elements."*

However, in some situations, assumed data may have been widely used; thus its replacement with actual data appears not to meet the exception described above because actual data was not "generally used," and thus the change to using actual data could be classified as a method change. Unless the change is within the 1% threshold required for automatic approval under Rev. Proc. 2017-56, such an update would trigger the requirement to apply for a method change.

This situation may come up for a terminating plan, where the valuation is based on final benefit calculations rather than estimated data. The automatic approval for fully funded terminated plans would provide approval for a change in data elements that falls outside of the 1% threshold. However, this automatic approval is only available if the plan was fully funded on the date of termination, disregarding contributions receivable.

So, it appears that where (a) a sponsor must contribute to fully fund the plan on a termination basis, and (b) a change in data elements replaces a widely used data estimate (i.e., actual data is not "generally used"), and (c) the change in data elements has more than a 1% effect on the funding target or target normal cost, IRS approval is required to reflect the actual data in the final valuation. Where to draw the line between when actual data is "generally used" and when it is not is unclear.

- Substitute mortality tables—update on the volume of substitute mortality table submissions received for 2018 plan years by Feb. 28, 2018. Have there been any issues that can be shared to help others in preparing the 2019 filings (that must be made by May 31, 2018)?

  The IRS/Treasury representatives pointed out that some of the applications were unclear about how the actuary adjusted for fractional-year exposures and recommended that the applications make this clear. Some applications also failed to adjust the rates over age 95. The representatives also pointed out that in computing the benefit dispersion factor, one should only square the benefit and not the fractional period.

  The Intersector Group commented on some of the challenges being encountered by those completing applications relating to changes in the plan population due to bulk lump sum payments or annuity purchases, both of which would reduce the size and change the composition of the plan. Annuity purchases generally cover a well-defined segment of the plan population, so the application process is generally relatively straightforward to repeat the analysis by excluding the affected population from the population. However, a bulk lump sum cashout generally applies only to the portion of the population electing to receive the lump sum. It would seem inappropriate to exclude just those electing the lump sum from the analysis as to do so would reduce the denominator of the mortality ratio without changing the numerator (because nobody who died would have been able to elect a lump sum). Should the filing be adjusted in some way if an annuity purchase is anticipated to take place sometime after the study period? Does the actuary have any obligation to reflect a change in the population (e.g., due to annuity purchase) that takes place after the study is complete if the change in headcount is less than 20% of the population?

  The IRS/Treasury representatives commented that a substitute mortality table is subject to the actuary's best estimate standard (in other words, although mortality in general is a prescribed assumption, the agency views substitute mortality tables as non-prescribed assumptions, or at least a hybrid between prescribed and non-prescribed). If the actuary believes that a substitute table that would otherwise apply is no longer accurately predictive of future mortality experience under the plan, then the actuary should so certify. Similarly, if the actuary believes that a table continues to be accurately predictive of future mortality experience, despite a change in covered population of more than 20%, then the actuary should so certify. If an annuity purchase is anticipated at the time of the application to the IRS, then to avoid later uncertainty, it would be helpful to mention this at the time of the application.

- Change in Enrolled Actuary—At a previous Intersector Group meeting, we discussed ways to handle changes in the enrolled actuary (e.g., in a takeover situation). For example, when do standing elections provided to the prior actuary cease to be effective? When must funding balance and method elections be directed to the new actuary? Is the IRS working on this issue and does it plan to issue any guidance in the future?

  The IRS/Treasury representatives asked about the helpfulness of tying the enrolled actuary assignment to a plan year rather than having the assignment change on a specific date.

  The Intersector Group responded that it would be helpful to have both options. Typically, in a takeover situation, the prior EA completes all of the tasks associated with a particular plan year while the new EA is responsible for the tasks associated with the following plan year, which can result in overlapping deadlines. In other cases, (e.g., a termination of employment or reassignment), the new EA may take over all responsibilities as of a specific date.

- In 2017, both the Academy and ACOPA wrote comment letters regarding the projection of variable interest credits for purposes of testing (under sections 411(b), 401(a)(4), 410(b), 401(a)(26), etc.) and other purposes. Members of the Intersector Group understood that the IRS may have been considering guidance in that area. Any update on this?

  The Intersector Group suggested that for purposes of prioritizing guidance topics, this should be one of the highest priority areas.

- IRC section 404 guidance—General question regarding the status of this guidance? This guidance is now more important for 2017 fiscal years due to the change in corporate tax rates.

  The Intersector Group members generally agreed that for purposes of prioritizing guidance topics this issue is one of the lower-priority areas, as the deductible limit generally leaves most plan sponsors plenty of flexibility and practitioners have been dealing with the PPA updates to IRC section 404 for over 10 years now (although this limit may come into play more frequently early in a new plan's existence). However, the next topic, relating to the timing of contributions, is very time-critical in light of tax reform.

- Contribution deductions—the extension of the filing deadline for corporate tax returns (without a corresponding adjustment of the deadline for minimum funding) is creating confusion. What's the IRS position on whether a contribution made after Sept. 15, 2018, but by Oct. 15, 2018, can be deducted in 2017 (for a calendar plan and tax year)? Where plan and tax years don't align, is there some general position that can be considered acceptable (e.g., if the tax year for which the deduction is being claimed overlaps with the plan year to which the contribution is being attributed, then the contribution can be considered as "on account of" that tax year)?

The IRS/Treasury representatives indicated that based on Rev. Rul. 76-28, which still applies, if the plan and tax year coincide, then a contribution made after the Schedule SB deadline may <u>not</u> be treated as being on account of the preceding tax year despite the one-month extension of the tax filing deadline.

The Intersector Group pointed out that additional clarity is still needed on this issue when plan and tax years do not coincide.

[Note: The example at the end of the following paragraph (which is not italicized) represents the Intersector Group members' interpretation and was not provided by the IRS meeting participants.]

A contribution made after the end of a tax year can be deducted for that tax year if (a) it is made before the tax return deadline for that tax year (and claimed as a deduction for that tax year) and (b) it is treated by the plan in the same manner as a contribution actually made on the last day of that tax year could be treated. In other words, it is recorded on a Schedule SB on which a contribution actually made on the last day of the tax year could be recorded. Depending on the plan year and tax year, there may be two, one, or no Schedules SB that would allow such a deduction. For example, for a calendar-year plan where the plan and tax years coincide, a contribution made after Sept. 15, 2018, but on or before Oct. 15, 2018, cannot be deducted for the 2017 tax year. While such a contribution may be made prior to the deadline for filing the 2017 tax return, such a contribution cannot be recorded on the 2017 Schedule SB (the only SB that would apply if the contribution were, in fact, contributed on Dec. 31, 2017). Therefore, the contribution can only be deducted for 2018. If, on the other hand, the plan year in this example runs from Feb. 1 to Jan. 31, then a contribution made by Oct. 15, 2018, can be recorded on the 2017 Schedule SB (the same Schedule SB that a Dec. 31, 2017, contribution could have been recorded on). The contribution can therefore be deducted for 2017 as long as it is, in fact, recorded on the 2017 Schedule SB. If, instead, the plan year in this example runs from May 1 to April 30, a contribution made on Dec. 31, 2017 could be recorded on either the 2016 or 2017 Schedule SB. Again, this would permit deduction for 2017 of a contribution made by Oct. 15, 2018, that is put on the 2016 or 2017 Schedule SB.

The fact that after PPA contributions made after the end of the year are not treated by the plan in exactly the same manner as a contribution made on the last day of the plan year, due to post-PPA interest discounting, is not relevant according to IRS. Such a difference may be disregarded in applying Rev. Rul. 76-28.

- Multiemployer plans, freezing legacy plans—Some plan sponsors froze their legacy plans and started new, separate plans for future service. A motivation for this action is to encourage new employers to participate in the plan while being completely isolated from the legacy liability. Is there any point of view toward this practice?

The IRS/Treasury representatives noted that they have had discussions with other agencies on this topic. A prime issue is the allocation of future contributions between the frozen legacy plan and the new plan, and how the transaction affects projected funding for the legacy plan. It was noted that the practice of freezing legacy plans will be significantly affected if the Give Retirement Options to Workers (GROW) Act becomes law. (Under the GROW Act, new employers that participate in a multiemployer pension plan with a "composite" design will not be exposed to unfunded legacy liability.)

- Multiemployer plans, end of rehabilitation period—If the trustees of a multiemployer plan determine that they have exhausted all reasonable measures and cannot reasonably emerge from critical status by the end of the 10-year "rehabilitation period," the statute permits the trustees to adopt a rehabilitation plan that instead targets emergence at a later date (or forestallment of possible insolvency). Even if the rehabilitation plan targets delayed emergence, however, the rehabilitation period remains fixed. This issue poses a potential problem, because excise taxes apply in situations when a plan has not emerged from critical status by the end of the rehabilitation period.

  For multiemployer plans that first entered critical status in 2008, it is possible that their rehabilitation period could end as soon as this December, and many plans are operating under rehabilitation plans that target delayed emergence. What is the current thinking as to the deficiency and excise tax for those situations, given IRC section 4971(g)(1) seems to provide a continued exemption? In particular, how does the IRS interpret IRC section 4971(g)(3)(B)(i)? A similar issue arises for seriously endangered plans, based on (3)(A) of that subsection. Finally, what is the current thinking on the waiver provision for "reasonable cause" situations in subsection (g)(5), especially as applicable to those seriously endangered plans?

  The IRS/Treasury representatives acknowledged that the applicable statute is flawed, and allows for the excise tax to be applied to plans that have not emerged at the end of the rehabilitation period. However, unlike for single-employer plans, the IRS can grant a waiver of the excise tax. The representatives noted that while it is theoretically possible some rehabilitation periods will end in December 2018, this issue will become more pressing in three to five years. For that reason, other more urgent matters (most notably, tax reform) have received more attention by the IRS/Treasury.

  The IRS/Treasury representatives noted that this issue could be resolved with technical corrections to the statute, which could be part of a broad recommendation by the Joint Select Committee on Solvency of Multiemployer Pension Plans. The representatives also noted that any suggestions on how to resolve this issue would be welcome.

- Multiemployer plans, treatment of beneficiaries of disability benefits in a suspension of benefits under MPRA.

  The IRS/Treasury representatives offered guidance that in a proposed suspension of benefits under the Multiemployer Pension Reform Act of 2014 (MPRA), protections *related to disability benefits do not extend to beneficiaries. In other words, the statutory limitation that a suspension of benefits cannot reduce a disability benefit does not apply to beneficiaries or surviving spouses of participants collecting disability benefits. Therefore, if the trustees decide not to apply reductions to the survivor portion of disability benefits, the trustees should describe that feature as part of the design of the proposed suspension, and not as a statutory protection.*

- A number of plan sponsors are currently awaiting determination letters for terminating plans. The process seems to have slowed down a fair amount. Is this due to limited IRS resources or other reasons? Also, what can plan sponsors expect going forward—e.g., is this delay expected to be temporary?

    The IRS/Treasury representatives indicated that the backlog is currently around six months for getting a case assigned, compared to a typical delay of three to six months for getting cases assigned. However, inventory is currently low. Anything that comes in now should be assigned within three months. This timeframe will likely go down in the near future unless volume picks up. Occasionally cases are assigned but the plan sponsor doesn't hear about it right away. If a sponsor is aware of a case that has been submitted and the sponsor hasn't heard from the IRS for six months, then the sponsor might want to call to confirm it has been assigned.

    The representatives also indicated that plan sponsors should not submit summaries of plan provisions, but should provide the actual plan document (in addition to any subsequent amendments).

- Is the IRS considering issuing determination letters for situations other than plan inception and termination, or is that unlikely due to the longer turnaround time for plan terminations?

    The IRS/Treasury representatives were unable to comment on whether the determination letter program might be expanded. The representatives indicated that if a plan sponsor has a particular issue on which they would like a ruling, it is recommended that they seek a pre-submission conference. This will help to determine whether the agency would likely be able to provide a ruling, and if so, what type of ruling (Private Letter Ruling? Determination Letter? Method change?). The IRS would also indicate an acceptable scope for the request. The conference can also help avoid an incomplete application and triggering the resulting 21-day clock for providing missing items (which the IRS is diligent about enforcing). The representatives noted, however, that the Private Letter Ruling process is not a backdoor way to address issues that would normally be covered by a determination letter filing.

Part II: Questions From the Agencies to the Profession

- The IRS/Treasury representatives asked about the historical IRS practice of posting the composite corporate bond yield rates and whether this rate is still used.

The Intersector Group expressed the view that this rate is no longer needed, although the group pointed out that some plans may still reference this rate.

The IRS/Treasury representatives indicated that a plan that references a rate that is no longer published should be amended to replace that rate with a similar published rate.

Additional Issues Discussed

The meaning of a "non-de minimis impact" justifying a delay in the updated IRC section 430 mortality tables to 2019 was discussed. What records do plan sponsors need to keep? What if the effect of implementing the updated tables is simply a faster use of funding balance?

The IRS indicated that the agency could have come up with a tighter standard if it had wanted to. Plan sponsors need to determine the effect (e.g., on contributions or PBGC premiums) before they can determine whether the effect is de minimis. The plan sponsor bears the burden of meeting the standard.