ASPPA
WORKING FOR AMERICA'S RETIREMENT



## Testimony before the Internal Revenue Service

### Public Hearing on the Limitations on Benefits and Contributions under Qualified Plans

**August 17, 2005**

Thank you, for the opportunity to testify on this important subject. I am the President of Stephen H. Rosen & Associates, Inc., an actuarial consulting firm in the Philadelphia area. My firm is also a division of National Investment Managers, Inc., which is a national pension plan administration and investment management firm.

I am here today to present the views of ASPPA, for which I currently serve as President. ASPPA is a national organization of over 5,500 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers.

ASPPA commends the Treasury and the Service for their efforts to update the Section 415 regulations for the various statutory changes adopted since the current final regulations were issued in 1981. ASPPA has submitted two comment letters on the proposed amendments to the Section 415 regulations setting forth our specific concerns. I will focus today on three major issues where ASPPA feels the proposed regulations take a contrary interpretation to the current understanding of pension professionals, providing undesirable results from a retirement policy perspective.

**Proposed Rules Applying the IRC §401(a)(17) Compensation Limit to the IRC §415 Limit**

The Section 415 limit has been commonly understood to apply after a participant's accrued benefit is determined, as opposed to being part of the accrued benefit computation. The compensation limit under Section 401(a)(17), on the other hand, limits the amount of compensation permitted to be considered in determining a participant's accrued benefit, and also applies for purposes of certain nondiscrimination rules. Until now, there was no question that in computing the Section 415 limit, a participant's compensation would not be restricted by the Section 401(a)(17) compensation limit.

The Proposed Regulations would change this long-established interpretation of the Section 415 limit by requiring the Section 401(a)(17) compensation limit be taken into account in determining a participant's maximum annual benefit under Section 415. This interpretation is in direct conflict with relevant statutory language, legislative history, current regulations and existing IRS guidance (including the IRS's Audit Guidelines), which support, directly or indirectly, that the compensation used in applying Section 415 limits should not be restricted by the Section 401(a)(17) limit. There is no direct statutory authority or legislative history of statutory changes linking the two Code sections, and up until now, the Treasury and IRS have never linked the two sections through their regulations or examination guidelines.

ASPPA believes that applying the Section 401(a)(17) limit to the maximum benefit under Section 415 would be wholly inappropriate. This change in the regulations would mostly affect a small subset of older participants, causing undesirable retirement policy results. The most profound impact of this new restriction would occur for older participants who work beyond the normal retirement age of age 65. Under the proposed regulations, for some of these older workers the Section 401(a)(17) limit would override the Section 415 limit, resulting in a significant benefit cut. A related problem occurs for participants who do not work past the normal retirement age, but who defer commencement of his or her benefit beyond age 65.

Application of the Section 401(a)(17) to the Section 415 limit would produce an inherently unfair result for those participants who (for whatever reason) defer commencement of pension payments or choose to take a later retirement. ASPPA believes any consequence of the proposed Section 415 regulations that would negatively impact older workers almost exclusively would be extremely unfair.

Therefore, ASPPA recommends that the proposed application of Section 401(a)(17) limit to the Section 415 limit be eliminated from the final proposed regulations and be conformed to existing guidance as it directly conflicts with most existing authority and produces results that were not intended by Congress.

**Treatment of Pre-participation Service in Determining a Defined Benefit Plan Participant's High Three-Years of Compensation**

As you know, the Section 415 limit on annual benefits payable under a defined benefit plan takes into account a participant's highest three consecutive years of compensation. Under prior guidance this three-year average could include any year in which the participant received compensation from the employer, regardless of whether the participant was participating in the plan that year. The Proposed Regulations would change this rule by limiting it only to a three-year period when a participant was an "active participant" in a plan.

Since 1980, it has been acceptable to consider any three-year period of service, whether or not a participant was an active participant during that period. While the Section 415 statutory language, (which has remained unchanged since enactment of ERISA) arguably supports the proposed change to the calculation of the three-year average, there is legislative history that conflicts with the statutory language regarding the high three-year average by referencing years of "employment."

ASPPA believes that the proposed change would be unfair to owner-employees who participate in a pension plan as it is not uncommon for the highest three paid years to occur before commencement of plan participation. There can often be a profound change in compensation when the owner-employee of a corporation establishes a plan, which often reduces the profits of a company and in turn the owner's compensation. We believe ignoring these early years of service for owner-employees would discourage the formation of new pension plans. We therefore believe the existing understanding of this rule better reflects Congressional intent and is generally a more reasonable approach.

Alternatively, we believe a fairer result could be achieved if the Proposed Regulations were to be revised to extend participation retroactively to a prior period of service, similar to what is currently permitted under the Section 401(a)(4) nondiscrimination rules. Similar to these rules, ASPPA believes that where prior years of service are counted under a plan for accrual purposes, those prior years of service should be treated as "participation service" for purposes of determining the Section 415 limit. We note that 401(a)(4) contains a five-year safe harbor past service credit. ASPPA believes a similar five-year safe harbor could be used in this context, with the five years to the start of actual participation being eligible for the high three-year average.

Therefore, ASPPA recommends that the prior interpretation of the high three-year average remain in the final Section 415 regulations. The Proposed Regulations do not reflect the intent of Congress and diverge from almost three decades of consistent treatment. At the very least, ASPPA asks that the final regulations permit consideration of extending participation retroactively to a prior period of service, and consider a safe harbor similar to the regulatory five-year safe harbor for past service credit.

**Effective Date of Regulations**

The proposed regulations provide that the final rules will be effective for limitation years beginning on or after January 1, 2007, with a "grandfather" provision that would apply to defined benefit plans with an effective date of May 31, 2005. This grandfather provision provides that in order to meet the Section 415 limit as of the effective date of the final regulations, the accrued benefit must be in accordance to plan provisions adopted and effective before May 31, 2005, a well as meet the "statutory provisions, regulations, and other published guidance in effect on May 31, 2005." ASPPA believes this requirement is unfair to plan sponsors and plan participants alike and in effect, masks a retroactive effective date.

Basing a grandfather provision on plan provisions in affect on May 31, 2005, means that any benefit provided by a defined benefit plan adopted after May 31, or benefits attributable to a post-May 31 amendment, will not be covered by the grandfather. ASPPA believes that plans designed in good faith by following clearly articulated guidance that has been in effect for almost 30 years should not be subjected to a retroactive application of the final regulation. We believe companies will choose not to implement a new defined benefit plan after May 31, 2005, and before the final regulations become effective because of the uncertainly regarding this important limit on benefits. This is especially true for small companies, which commonly provide benefits up to the Section 415 limit for the company's owner.

The May 31 date is also problematic for existing plans in that it interferes with a company's ability to favorably design its plan due to the uncertainty regarding the final regulations, and places the plan in a state of limbo from making any changes to its plan from May 31, 2005, until the regulations are finalized.

ASPPA believes a better approach would be to provide that all benefits accrued as of the date immediately before the first day of the limitation year to which the final regulations apply be grandfathered, provided the plan met the legal requirement in effect as of such date. We would request that the IRS notify the pension community (perhaps through the IRS Web site) as soon as possible if it is likely that the current effective date in the proposed regulations will be changed so that practitioners can continue advising their clients with some reasonable certainty until the regulations are finalized.

**Conclusion**

ASPPA appreciates this opportunity to speak before the IRS and Treasury today about these very important issues. We look forward to working with you on these and other important issues relating to the Section 415 regulations in the future. Thank you.