Changes Made to IRC Section 412(b)(2)(E) by P.L. 105-34

November 15, 1999

Mr. Martin Pippins
Chief Actuarial Branch 2
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

RE: Changes Made to IRC Section 412(b)(2)(E) by P.L. 105-34

Dear Mr. Pippins:

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.

The purpose of this letter is to highlight issues raised by the addition of IRC Section 412(b)(2)(E) by the Taxpayer Relief Act of 1997.

OBRA '87 first imposed this alternative full funding limit. The Service was given the authority under 412(c)(7)(D) to determine the treatment of foregone contributions in subsequent years when the limit no longer applied. Committee reports suggested the Service take into account "factors such as the remaining working lifetime of participants". In response, the Service provided for a ten year amortization period in the instructions to the Schedule B of Form 5500. It was not made clear whether this period applied in the case of all funding methods or merely those that call for the establishment of bases.

The use of a fixed amortization period made the amortization process administratively feasible for plans with immediate gain funding methods, such as Unit Credit. Because a spread gain method inherently takes into account amortization over future working lifetime, establishment of a separate base is not necessary to achieve the stated goal. However, many actuaries believed that they were supposed to amortize this charge over ten years for spread gain methods, too. (When questioned privately, some representatives of the Service acknowledged that spread gain methods such as Individual Aggregate did not have to establish amortization bases, or at least the Service would not challenge them if they failed to establish amortization bases.)

In the Taxpayer Relief Act of 1997, Congress changed the amortization period to twenty years. The conference agreement made it clear, however, that "no amortization is required with respect to funding methods that do not provide for amortization bases".

Looking at the entire legislative history, it is clear that Congress intends first, that the amortization period for immediate gain methods should be twenty years instead of the ten years proposed by the Service in the instructions to the Schedule B, and second, that spread gain methods (except for some Frozen Initial Liability methods) should not be required to create amortization bases.

ASPPA believes that after recognizing the mandate in the legislative history, there are six issues left:

1. If the actuary had established a base solely for this purpose, is any special transition required for eliminating the base?
2. If the actuary has already eliminated bases prior to the effective date is any current action required?
3. What if the plan uses the FIL funding method and has combined these bases with other bases.
4. What if the plan uses an immediate gain method and has combined bases?
5. What if the plan changes funding methods:
a. Prior to the change in law;
b. After the change in law?
6. How is this impacted by the ERISA full funding limit?

Our suggestions are:

1. No, the base and amortization should be folded into future normal cost calculations.
2. The plan should have a free pass as to which year to apply the change in law.
3. There should be three options, keep the total unfunded, allow the unfunded to be reset to zero, or allow reconstruction.
4. There should be two options, allow the plan to ignore the change for prior years (i.e. keep the amortization payment the same), or allow reconstruction.
5. If a plan switches to a spread gain method, the full UAL (unfunded accrued liability) attributable to IRC Section 412(b)(E)(2) should disappear, and if the plan switches from spread gain to an immediate gain method then any UAL base actually set up for the years while spread gain should be retired. (There may be a delayed loss from the change in method, which should be amortized as if a current change in method.)
6. Amortization bases under IRC Section 412(b)(E)(2) should be zeroed out at the same time and in the same manner as any other UAL when the plan attains the ERISA full funding limit.

Any changes to the actuarial funding method due to the change in the law and clarification of existing law should be a "free" method change which counts neither against past or future changes in method.

We hope that our suggestions are useful to you in writing the guidance. Please keep in mind that many actuaries have already had to perform valuations for plan years beginning after December 31, 1998 and have had only the legislative history to which to look for guidance.

If you have any question with regard to this matter, please feel free to contact us.

Sincerely,

Kurt Piper, MSPA, Chair
ASPPA Regulations Subcommittee

Brian Graff, Esq.
ASPPA Executive Director

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