AMERICAN RETIREMENT ASSOCIATION
Working for America's Retirement
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May 30, 2019

Mr. Robert Choi
Director, Employee Plans
Internal Revenue Service
1750 Pennsylvania Avenue NW
Washington, DC 20006-4508

RE: Request for Post-PPA Guidance under Code Section 404(o)

Dear Mr. Choi:

The American Retirement Association ("ARA") is writing to request that the Internal Revenue Service ("IRS") issue guidance regarding the calculation of the deduction limit for a single-employer defined benefit plan ("DB Plan") under Section 404(o) of the Internal Revenue Code of 1986, as amended ("IRC"), which was added to the IRC by the Pension Protection Act of 2006 ("PPA"). This letter updates and reiterates many of the same points in an earlier letter dated August 19, 2013.

ARA is the coordinating entity for its five underlying affiliate organizations representing the full spectrum of America's private retirement system, the American Society of Pension Professionals and Actuaries ("ASPPA"), the National Association of Plan Advisors ("NAPA"), the National Tax-Deferred Savings Association ("NTSA"), the ASPPA College of Pension Actuaries ("ACOPA"), and the Plan Sponsor Council of America ("PSCA"). ARA's members include organizations of all sizes and industries across the nation who sponsor and/or support retirement savings plans and are dedicated to expanding on the success of employer provided plans. In addition, ARA has more than 26,000 individual members who provide consulting and administrative services to American workers, savers, and sponsors of retirement plans. ARA's members are diverse but united in their common dedication to the success of American's private retirement system. All credentialed actuarial members of ARA are members of the ACOPA, which has primary responsibility for the content of comment letters that involve actuarial issues.

Summary

ARA recommends that the IRS issue guidance related to the calculation of the deduction limit for a DB Plan under IRC section 404(o), which was added to the IRC by the PPA. The following is a summary of our recommendations which are described in greater detail in the **Discussion** section that follows.

I. Deductibility Under IRC section 404(o) When the Plan Year and the Sponsor's Taxable Year are Different

The IRS should issue guidance confirming that the options in the regulations under IRC section 404(a) for determining the deductibility of an employer contribution to a DB Plan

when the plan year of the plan and the taxable year of the plan sponsor are not the same can still be used by plan sponsors.

II. Small Plan Cushion Amount

The IRS should issue guidance providing that only an actual amendment to a DB Plan will be treated as an amendment for purposes of IRC section 404(o)(4).

III. At-Risk Calculation for a Plan that is not in At-Risk Status

The IRS should issue guidance clarifying that the IRC section 430(i) loading factors must be included when determining the Funding Target ("FT") and Target Normal Cost ("TNC") under IRC section 404(o)(2)(B) for a DB Plan that is not in at-risk status.

IV. Cushion Amount for Career Average Plan

The IRS should issue guidance providing that a career average plan may project the benefit payable at future dates using a salary scale, and multiply by the ratio of accrued service over total service at each projected payment date, to determine the target liability cushion amount.

V. Coordination of Minimum Required and Maximum Deductible Contributions

The IRS should issue guidance clarifying how the year for which a contribution is credited for minimum funding purposes affects the year for which an employer contribution to a DB Plan may be considered deductible by the employer under IRC section 404.

VI. Different Valuation Assets May Be Required For IRC section 430 And 404 Purposes

The IRS should issue guidance clarifying that, if a contribution made during a plan year was credited toward the minimum required contribution for a prior plan year, but was not deductible for the related taxable year, assets for determining the minimum required contribution under IRC section 430 should include the present value of the contribution and assets for determining the maximum deductible contribution under IRC section 404 should not include such contributions.

VII. Exceptions from Code Section 4972 Excise Tax on Excess Contributions

The IRS should issue guidance stating how to make a formal election under IRC section 4972(c)(7), given the holding in *Pizza Pro Equipment Leasing, Inc. v. Commissioner* that a taxpayer's non-filing of an excise tax return on Form 5330 did not constitute a valid election under IRC section 4972(c)(7). *See* 147 T.C. 14 (2016), *aff'd* 121 AFTR2d 2018-682 (8th Cir. 2018).

VIII. The IRC section 404(o) Maximum Deduction Amount

The IRS should issue guidance clarifying that the maximum amount that can be deducted under IRC section 404(o) for employer contributions made to a DB Plan for a given plan year includes the interest accrued on the Minimum Required Contribution ("MRC") at the Effective Interest Rate ("EIR") between the valuation date and the latest date the MRC can be timely deposited to the plan.

IX. Clarification of IRC 404(o) calculation for terminated plans

The IRS should clarify what is the allowable tax deduction for a contribution to a terminated plan that is deposited after the extended due date of the plan sponsor's tax return for the year of termination.

Discussion

I. Deductibility Under IRC section 404(o) When the Plan Year and the Sponsor's Taxable Year are Different

The regulations under IRC section 404(a) provide rules on determining the deductibility of an employer contribution to a DB Plan when the plan year of the plan and the taxable year of the plan sponsor are not the same.[1] In general, the regulations permit a plan sponsor to determine the deductible limit for its taxable year by using one of the following: (a) the limit determined for the plan year commencing within its taxable year; (b) the limit determined for the plan year ending within its taxable year; and (c) a weighted average of (a) and (b).[2] With the addition of IRC section 404(o), it is not clear whether these options remain available to plan sponsors.

ARA recommends that the IRS issue guidance confirming that the options in the regulations under IRC section 404(a) for determining the deductibility of an employer contribution to a DB Plan when the plan year of the plan and the taxable year of the plan sponsor are not the same can still be used by plan sponsors.

II. Small Plan Cushion Amount

In general, the Cushion Amount ("CA") for a plan year is calculated pursuant to the formula in IRC section 404(o)(3).[3] However, the CA can be limited for a plan with less than 100 participants.[4] Specifically, the "liability of the plan attributable to benefit increases for highly compensated employees … resulting ***from a plan amendment*** which is made or becomes effective, whichever is later, within the last 2 years shall not be taken into account in the determining the target liability"[5] used in calculating the CA for a small plan. (Emphasis added.)

Many plans provide for automatic increases and adjustments to certain limits and rates set forth in the IRC (including, but not limited to, the limits in IRC sections 415 and 401(a)(17), the rates in IRC section 417(e)(3), and benefit resumptions under IRC section 436). These increases and adjustments may cause benefits in a DB Plan to be increased automatically because changes in these limits and rates affect the plan's benefits. Although a DB Plan may be amended in order to initially include the automatic increases and adjustments described above, it is not amended each time the automatic increase or adjustment takes place.

ARA recommends that the IRS issue guidance providing that only an actual non-automatic amendment to a DB Plan will be treated as an amendment for purposes of IRC section 404(o)(4).

III. At-Risk Calculation for Determining the Maximum Deductible Contribution

The FT and TNC are components used to determine the maximum deductible amount under IRC section 404(o)[6] and the MRC under IRC section 430.[7] Special rules are applied under IRC section 430(i) when determining the FT and TNC of a DB Plan that is in at-risk status. Specifically, IRC

[1] *See,* Treas. Reg. §1.404(a)-14(c).
[2] *Id.*
[3] *See,* IRC §404(o)(3)(A).
[4] *See,* IRC §404(o)(4)(A).
[5] *Id.*
[6] *See,* IRC §404(o)(2)(A)(i)(I).
[7] *See,* IRC §430(a).

section 430(i) provides for the use of certain loading factors when calculating the FT and TNC of a DB Plan that has been in "at-risk status for at least 2 of the last 4 preceding plan years…"[8]

IRC section 404(o)(2)(B) requires a DB Plan that is not in at-risk status to calculate the FT and TNC "as if section 430(i) applied to the plan" when determining the maximum deductible amount under IRC section 404(o)(2)(A).[9] For a DB Plan that is not in at-risk status, it is not clear whether IRC section 404(o)(2)(B) requires the use of the IRC section 430(i) loading factors when calculating the FT and TNC in order to determine the maximum deductible amount. It is ARA's position that the loading factors should be applied to a DB Plan that is not in at-risk status because IRC section 404(o) calculation is not related to a "true" at-risk status. Instead, it is our understanding that it simply measures the maximum FT and TNC that could be calculated under at-risk status rules of IRC section 430(i).

ARA recommends that the IRS issue guidance clarifying that the IRC section 430(i) loading factors must be included when determining the FT and TNC under IRC section 404(o)(2)(B) for a DB Plan that is not in at-risk status.

IV. Cushion Amount for Career Average Plans

IRC section 404(o)(3)(A)[10] provides that the CA includes the increase in the FT that would result if future compensation increases are taken into account. Some plans that base benefits on compensation earned over the participants' career determine the accrued benefit by calculating career average compensation, then applying the benefit formula to that career average compensation. For these plans, it is clear that the CA would be based on projected career average compensation, and service accrued through the first day of the plan year. However, instead of calculating a career average of compensation, some plans determine the accrued benefit as the sum of each year's accrual based on that year's compensation. Arguably such a plan would not have an increase in target liability if future compensation increases are taken into account. However, determining differing CAs for plans that simply rearrange the order in which factors are applied (e.g., [sum of compensation/years of service] x 1% x years of service as compared to [sum of compensation x 1% for all years of service]) is not a logical result. Guidance should result in the same CA regardless of whether or not an average compensation is determined. Because cash balance plans are effectively career average plans, the rule for career average plans should also apply to cash balance arrangements.

ARA recommends that the IRS issue guidance providing career average plans and cash balance plans may determine the CA by projecting the benefit earned at the date of a future event and prorating for service accrued on the first day of the plan year.

V. Coordination of Minimum Required and Maximum Deductible Contributions

For purposes of determining if an employer contribution to a DB Plan is deductible under IRC section 404, "a taxpayer shall be deemed to have made a payment on the last day of the preceding taxable year if the payment is ***on account of such taxable year*** and is made ***not later than*** the time prescribed by law for filing the return for such taxable year (including extensions thereof)."[11]

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[8] *See,* IRC §§430(i)(1)(A)(ii) and (2)(B).
[9] *See,* IRC §§404(o)(2)(B)(i) and (B)(ii).
[10] *See,* IRC §404(o)(3)(A) (ii)(I).
[11] *See,* IRC §404(a)(6).

(Emphasis added.) However, the due date for making an MRC to a DB Plan under IRC section 430 is 8½ months after the end of the plan year.[12] As a result, the same employer contribution may be treated as a deductible contribution under IRC section 404 for one year and as an MRC under IRC section 430 for another year.

For example, Company A sponsors a DB Plan. The plan year and Company A's taxable year are the calendar year. Company A files its 2018 tax return on March 1, 2019 and makes an employer contribution on July 1, 2019. Company A's July 1, 2019 contribution would qualify as an MRC for the 2018 plan year under IRC section 430(j)(1) because it was made prior to September 15, 2019 (8½ months after the end of the 2018 plan year). However, because Company A made the contribution to the plan ***after*** the due date for filing its 2018 tax return (March 15, 2019), IRC section 404(a)(6) would require the July 1, 2019 plan contribution to be deductible in Company A's 2019 taxable year (as opposed to its 2018 taxable year).

Guidance is needed, however, to clarify how the rules apply in certain situations:

a) Assume Company A makes an employer contribution on February 1, 2019, and deducts the contribution for 2018. However, when the Schedule SB of the Form 5500 ("SB") is completed later that year, the February 1 contribution is omitted from the SB. (No funding deficiency results from the omission.) Guidance is needed as to whether a revised SB, including the February 1, 2019 contribution, must be filed for 2018 to support the deduction of that amount for 2018. ARA suggests that because the contribution was timely for purposes of IRC sections 430 *and* 404 with respect to the prior year, the employer's deduction of the contribution for the prior year indicates the contribution was "on account of" the prior year and a revised SB should not be required to support the deduction. The amount should simply be reported as a "contribution for the prior year' on the next SB.

b) Company A is a sole proprietor with a tax filing deadline extended to October 15, 2019. The contribution is made October 1, 2019, before the due date of the tax filings, but after the last day to qualify as an MRC for 2018. The interaction of IRC sections 430 and 404 are less clear in this circumstance. If, based on contributions made through September 15, 2019, a funding deficiency existed for 2018, to the extent the contribution does not exceed the amount of the deficiency on the date of deposit, the contribution is applied to the unpaid minimum required contribution for the prior year[13], and so is clearly made "on account of" the prior year. To the extent the contribution is not required to satisfy the prior year's MRC, it is not clear that a contribution made after the 8½ month deadline can be "on account of" the prior year. Guidance is needed regarding what amount is deductible in the prior year when the deposit date precedes the tax filing due date but is after the 8½ month MRC deadline.

[12] *See,* IRC §430(j)(1).

[13] IRC §4971(c)(4)(B).

ARA recommends that the IRS issue guidance:

a) clarifying whether or not a revised SB must be filed if a contribution made timely for both deduction and MRC purposes for the prior year was deducted for the prior year but not reported on the SB filed for prior year; and

b) clarifying how to determine the amount deductible for the prior year if the contribution is made before the due date of tax filings but after the MRC deadline for the prior year.

VI. Different Valuation Assets May Be Required for IRC sections 430 And 404 Purposes

The rules under IRC section 404(o) require a plan sponsor to use of the "value (determined under section 430(g)(3)) of the assets of the plan which are held by the plan as of the valuation date for the plan year"[14] when calculating the maximum deductible amount for employer contributions made to a DB Plan for each taxable year. IRC section 430(g)(4)(B) sets out rules for accounting for contributions made for the current year but before the valuation date, providing that those contributions plus interest from the date of the contribution through the valuation date are to be excluded from the plan assets determined in IRC section 430(g)(3). An analogous situation exists for purposes of IRC section 404(o) assets when a contribution is deposited before the valuation date, but was not deducted for the prior year.

Contributions may require different treatment under IRC section 430(g)(4) for purposes of determining the MRC and the maximum deductible amount. If a contribution was not deducted for the prior year, but was made timely for purposes of IRC section 430 and reported as a contribution on the SB for the prior year, the contribution adjusted for interest should be excluded from the value of assets for purposes of determining the maximum deductible contribution under IRC section 404(o) and included for determining the MRC under IRC section 430.

For example, Company A sponsors a DB Plan. The plan year and taxable years are the calendar year. The valuation date is the last day of the plan year. The fair market value of plan assets as of December 31, 2017 is $100,000, including a $15,000 employer contribution made on September 1, 2018. This contribution was reported on the 2017 SB as a contribution toward the MRC requirement under IRC section 430 for 2017, but was not deducted in 2017. The present value of the contribution adjusted for the EIR to December 31, 2017 is $15,294.

The value of plan assets used to determine the MRC for the 2018 plan year is $100,000. However, assets used to determine the maximum deductible amount should not include the value of a contribution that has not yet been deducted, so the value of plan assets that should be used when determining the maximum deductible amount under IRC section 404(o) is $84,706 (the fair market value of plan assets as of December 31, 2018, excluding the $15,294 EIR-adjusted contribution).

ARA recommends that the IRS issue guidance clarifying that the value of DB Plan assets required to be used under IRC section 404(o)(2)(A)(ii) should exclude contributions not deducted in prior years, adjusted at the EIR pursuant to IRC section 430(g)(4)(B).

VII. Exceptions from Code Section 4972 Excise Tax on Excess Contributions

Prior to the enactment of the PPA, IRC section 4972(c)(7) provided that in "determining the amount of nondeductible contributions for any taxable year, an employer may elect for such plan year to take into account any contributions to a defined benefit plan except to the extent that such

[14] IRC §404(o)(2)(A)(ii).

contributions **exceed the full-funding limitation** (as defined in section 412(c)(7), determined without regard to subparagraph (A)(i)(I) thereof)." (Emphasis added.) The PPA amended IRC section 4972(c)(7) to remove the requirement that the contributions "exceed the full-funding limitation" for a DB Plan.[15] As a result, a plan sponsor may elect to be exempt from the IRC section 4972 excise tax on *all* contributions made to a DB Plan.

For example, Company A sponsors both a DB Plan and a defined contribution plan. The plan years and the fiscal year are the calendar year. The maximum deductible contribution for the DB Plan is $100,000 without regard to IRC section 404(a)(7). Company A actually contributes $150,000 to the DB Plan and also makes a contribution of $100,000 to the defined contribution plan. Both contributions are made before the due date of the 2017 tax return. Covered payroll is the same for both plans and is $500,000. Under IRC section 404(a)(7), the maximum deductible contribution is the DB Plan's MRC or a combined limit for both plans of $125,000 (25% of $500,000). However, for purposes of this second limit, the first $30,000 (6% of total payroll of $500,000) contributed to the defined contribution plan is not considered.

Under IRC section 404(a)(7), the employer may claim a 2017 deduction of $155,000 ($125,000 plus $30,000). Under IRC section 4972(c)(7), Company A may designate nondeductible contribution of $95,000 to be from the DB Plan contribution and avoid the IRC section 4972 excise tax. The $95,000 DB Plan contribution will be deducted in future years.

The statute does not specify the form or timing of the employer's election of the IRC section 4972(c)(7) exception. The Tax Court, however, has weighed in by holding that a taxpayer failed to make a valid election under IRC section 4972(c)(7) by not filing a Form 5330. *See Pizza Pro v. Commissioner*, 147 T.C. 14 (2016). The view of the Tax Court was affirmed by the Court of Appeals for the Eighth Circuit. *See* 121 AFTR2d 2018-682 (8TH Cir. 2018).

ARA recommends that the IRS issue guidance stating how to make a formal election under IRC 4972(c)(7), considering the holding in *Pizza Pro v. Commissioner*.

VIII. The IRC section 404(o) Maximum Deduction Amount

IRC section 404(o) sets forth the rules for determining the deduction limit for employer contributions made to a DB Plan. In general, the maximum deductible amount calculation for a particular plan year begins as the sum of: (a) the FT,[16] (b) the TNC,[17] and (c) the CA,[18] minus the value of plan assets as of the valuation date.[19] It is then set at the greater of: (1) the amount calculated above, or (2) the MRC calculated under IRC section 430 for the plan year.[20]

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[15] *See,* IRC §430(j)(2) (stating "In determining the amount of nondeductible contributions for any taxable year, an employer may elect for such plan year to take into account any contributions to a defined benefit plan except, **in the case of a multiemployer plan**, to the extent that such contributions exceed the full-funding limitation (as defined in section 431(c)(6))"). (Emphasis added.)

[16] *See,* IRC §430(d)(1).

[17] *See,* IRC §430(b)(1).

[18] *See,* IRC §404(o)(3)(A).

[19] *See,* IRC §404(o)(2)(A).

[20] *See,* IRC §404(o)(1).

Generally, the MRC for the plan year is calculated under IRC section 430 as the sum of: (a) the TNC, (b) the shortfall amortization charge,[21] and (c) the waiver amortization charge.[22] The plan sponsor must then contribute the MRC, "adjusted for interest accruing for the period between the valuation date and the payment date, at the effective rate of interest for the plan for such plan year"[23] within 8½ months after the close of the plan year.[24] Guidance is needed to clarify that the calculation of the MRC used in determining the maximum amount of employer contributions that can be deducted for any given plan year under IRC section 404(o) includes the interest required to be added to the MRC under IRC section 430(j), and that the maximum deductible amount includes interest through the last date the employer could make the contribution and avoid a funding deficiency. For example, suppose the MRC for the 2018 plan year is $100,000 and the plan's EIR is 6.00%. Also assume the TNC and cushion amount are zero. The maximum deductible amount for the plan year, assuming the plan sponsor makes the contribution 8½ months after the end of the year, is $110,467 (the $100,000 MRC increased by the EIR through September 15, 2019). The plan sponsor makes the contribution for the 2018 plan year on March 15, 2019. The contribution must be at least $107,295 (the $100,000 MRC increased by the EIR through March 15, 2019) to satisfy the minimum funding standards, and can be as much as $110,467 in order to be fully deductible for 2018.

ARA recommends that the IRS issue guidance clarifying that the MRC used in calculating the maximum amount that can be deducted under IRC section 404(o) for employer contributions made to a DB Plan for a given plan year includes the interest accrued on the MRC at the EIR between the valuation date and the latest date the MRC can be made to the plan.

In addition, IRC section 404(o)(6) states that: "Any computation under this subsection for any plan year shall use the same actuarial assumptions which are used for the plan year under section 430 (determined by not taking into account any adjustment under clause (iv) of subsection (h)(2)(C) thereof)." As stated above, the maximum deductible amount calculation for a particular plan year begins as the sum of: (a) the funding target, (b) the target normal cost ,and (c) the cushion amount; minus the value of plan assets as of the valuation date. It is then set at the greater of: (1) the amount calculated above, or (2) the MRC calculated under IRC section 430 for the plan year. Is the MRC calculated under IRC section 430 (including the at-risk calculation) recalculated using IRC section 404 rates because of the wording of IRC section 404(o)(6)?

ARA recommends that IRC section 404(o)(6) be interpreted as not requiring the recalculation of the IRC section 430 MRC using section 404 rates.

IX. Clarification of IRC section 404(o) calculation for terminated plans

IRC section 404(o)(5) allows a deduction for a contribution to fully fund all benefit liabilities (within the meaning of ERISA section 4041(d)). In many cases, the amount needed to make the plan sufficient for benefit liabilities for the year of termination is not known at the time the employer's tax return is filed. This amount is required to be paid to make the plan sufficient to terminate and, as such, should be deductible for the year in which the actual payment is made (but not in a later year). Employers should not be put in a position of overfunding the plan using the

[21] *See,* IRC §430(c).
[22] *See,* IRC §430(e).
[23] *See,* IRC §430(j)(2).
[24] *See,* IRC §430(j)(1).

cushion amount and then subsequently have to pay a reversion excise tax. The better policy result is to allow employers to deduct the actual amount needed to pay the termination contribution even if the contribution cannot be made until after the extended due date of the employer's tax return. It is not uncommon for the completion of the termination process to be delayed for reasons beyond the control of a plan sponsor, such as waiting for PBGC or IRS audits to be completed or securing a timely annuity quote from an insurance company. ***ARA recommends*** that the IRS clarify what is the allowable tax deduction for a contribution to a terminated plan that is deposited after the extended due date of the plan sponsor's tax return for the year of termination.

These comments were prepared by the ACOPA Government Affairs Committee. Please contact Martin L. Pippins, MSPA, Director of Regulatory Affairs, at (703) 516-9300 ext. 146 if you have any comments or questions on the matters discussed above.

Thank you for your time and consideration.

Sincerely,

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