The
ERISA
Industry
Committe

COMMENTS OF
THE ERISA INDUSTRY COMMITTEE

PROPOSED AMENDMENTS TO THE REGULATIONS
ON
THE LIMITATIONS ON BENEFITS AND CONTRIBUTIONS
UNDER
QUALIFIED PLANS

July 27, 2005

The ERISA Industry Committee ("ERIC")[1] is pleased to submit the following comments on the proposed amendments to the regulations under Internal Revenue Code ("Code") section 415 regarding the limitations on benefits and contributions under tax-qualified plans. The proposed regulations were published in the May 31, 2005, issue of the Federal Register. 70 Fed. Reg. 31,214. The preamble to the proposed regulations states that comments on the proposed regulations must be submitted by July 27, 2005. ERIC reserves the right to supplement these comments to reflect any additional concerns that its members identify as a result of their continued attention to the proposed regulations.

I. Background

Section 415 limits the benefits that a qualified defined benefit plan may provide to a participant and the additions that may be made to a participant's account in a year under a qualified defined contribution plan. Every tax-qualified plan is subject to the § 415 limits.

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[1] ERIC is a nonprofit association committed to the advancement of the employee retirement, health, incentive, and compensation plans of America's major employers. ERIC's members provide comprehensive benefits to tens of millions of active and retired workers and their families and beneficiaries. ERIC's members' plans are the benchmarks against which industry, third-party providers, consultants, and policy makers measure the design and effectiveness of employee benefit, incentive, and compensation plans. ERIC's members are engaged daily with meeting both the demands of their enterprise and the needs of employees while dealing with an increasingly complex web of benefit and compensation laws. ERIC, therefore, is vitally concerned with proposals affecting its members' ability to provide employee benefits, incentive, and compensation plans, their costs and effectiveness, and the role of those plans in the American economy.

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Because a plan must comply with § 415 in order to be tax-qualified, employers and plan administrators have invested substantial resources over the years to assure that their plans comply with § 415. This has included (1) evaluating and making the elections offered by the existing § 415 regulations, (2) drafting and adopting appropriate plan provisions, and (3) designing and implementing administrative systems to assure that the plan complies with § 415 in operation.

Section 415 was added to the Code by ERISA in 1974, and the Treasury[2] issued regulations under § 415 in 1981. Although § 415 has since been amended on many occasions, most of those amendments have been reflected in notices and revenue rulings rather than in amendments to the regulations.

ERIC very much appreciates the Treasury's proposal to consolidate its prior guidance under § 415 in a single set of regulations. Consolidation of the prior guidance will foster understanding of, and compliance with, the § 415 limits.

Although the proposed regulations reflect the amendments that Congress has enacted since 1981, the proposed regulations do far more than this. The proposed regulations include significant changes that are unrelated to any amendments to § 415.

ERIC has serious concerns about a number of these proposed amendments -- amendments that are not necessitated by legislation, but that attempt to resolve issues that were either not addressed or addressed differently in 1981. A number of these amendments are excessively complex and restrictive and will have practical consequences that the drafters might not have anticipated. A number of these amendments will require costly changes in the systems that employers now have in place to comply with § 415.

The complexity and restrictiveness of the proposed regulations -- and particularly the proposed provisions governing participants with multiple annuity starting dates (the "MASD provisions") -- pose acute problems for major employers. The proposed MASD provisions create enormous practical problems for the types of defined benefit plans that major employers sponsor.

For a variety of reasons, including mergers, acquisitions, and involvement in multiple lines of business, many major employers and their affiliates sponsor numerous defined benefit plans, many of them with a wide variety of benefit distribution options and a variety of permissible annuity starting dates. Due to job changes and other reasons, employees often earn benefits under more than one defined benefit plan during their tenure with the same employer. In addition, some major employers offer, or are considering, phased retirement opportunities under which an eligible employee may elect to start receiving part of his or her pension benefit as the employee's work schedule declines. In addition, some major employers amend their defined benefit plans from time to time to grant ad hoc benefit

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[2] In the interest of simplicity, we use "Treasury" in this submission to refer to both the Treasury Department and the Internal Revenue Service.

increases to retirees (“ad hoc COLAs”). The proposed MASD provisions undermine all of these practices.

At the same time, major employers report that because of the compensation limit imposed by § 401(a)(17) and the nondiscrimination requirements imposed by § 401(a)(4), the § 415(b) limits on defined benefit plans affect very few employees. Accordingly, from the perspective of major employers, the proposed regulations’ complexity and restrictiveness are disproportionate to the § 415(b) limits’ diminished practical significance.

Unnecessarily complex and restrictive regulations that are not required by legislation and that subject plans to substantial unanticipated costs will provide yet another reason for employers to reduce or end their participation in the voluntary pension system. The Treasury should not issue regulations that have this effect.

II. Summary of Comments

A. Definition of Compensation

1. The Treasury should amend proposed § 1.415(c)-2(e)(1)(ii) to delete the requirement that, in order to be taken into account under § 415, compensation must be paid (or treated as paid) to the employee prior to the employee’s severance from employment with the employer maintaining the plan.

2. If the Treasury does not accept the preceding comment, the Treasury should at least amend proposed § 1.415(c)-2(e) to provide that the exclusion from the regulations’ definition of compensation for amounts paid after severance from employment does not apply to amounts received by an employee before the end of the limitation year in which the employee severs from employment.

3. The Treasury should amend proposed §§ 1.415(c)-2(c)(1), -2(d), and -2(e)(3)(iii) to clarify the circumstances in which amounts received by an employee under a nonqualified deferred compensation plan are treated as compensation for purposes of § 415.

4. The Treasury should amend proposed § 1.415(c)-2(f) to delete the requirement that the definition of compensation that a plan uses in applying the § 415 limitations must not reflect compensation exceeding the limit imposed by § 401(a)(17).

5. The Treasury should amend proposed § 1.415(c)-2 to provide clear, consistent, and appropriate treatment of nonresident aliens.

B. Defined Benefit Plan Limits

1. The Treasury should amend proposed § 1.415(b)-2 to provide greater flexibility in applying the § 415(b) limits to a participant who receives plan distributions prior to either an increase in his or her accrued benefit or a subsequent annuity starting date.

2. The Treasury should amend proposed § 1.415(b)-1(a)(1) to provide that § 415(b) limits the benefit accruals, rather than the benefit payments, under a defined benefit plan.

3. The Treasury should amend proposed § 1.415(b)-1 to add rules for corrective distributions from defined benefit plans that are comparable to the rules in § 1.415(c)-1(b) for benefit restorations and corrective contributions to defined contribution plans.

4. The Treasury should amend proposed § 1.415(b)-1 to provide that the applicable dollar limit may not decline on account of the employee's increasing age or service.

5. The Treasury should amend proposed § 1.415(d)-1(d) to make clear that its conclusion -- that a pattern of repeated plan amendments to reflect increases in the § 415(b) limits pursuant to § 415(d) does not create a § 411(d)(6)-protected right to future increases in the § 415(b) limits -- illustrates a generally applicable rule: that a pattern of repeated plan amendments that create additional benefit accruals does not create a § 411(d)(6)-protected right to additional benefit accruals.

6. The Treasury should amend proposed § 1.415(b)-1(a)(5) to eliminate the double proration of benefits.

C. Defined Contribution Plan Limits

1. The Treasury should amend proposed §§ 1.415(c)-1(b)(2)(ii)(A) and 1.415(c)-1(b)(3)(iii) to clarify the definitions of the benefit restorations and repayments that are not treated as annual additions.

D. Plan-to-Plan Transfers

1. The Treasury should amend proposed § 1.415(b)-1(b)(3) to treat a transfer of benefits from a transferor defined benefit plan to a transferee defined benefit plan that is not aggregated with the transferor plan under § 415(f) as a transfer of *liabilities* rather than as a transfer of *assets.*

2. The Treasury should amend proposed § 1.415(b)-1(b)(3) to address the treatment of multiple employer plans that are involved in plan-to-plan transfers.

3. The Treasury should amend proposed §§ 1.415(b)-1(b)(2)(v) and 1.415(b)-1(b)(3)(iii) to permit the use of realistic assumptions to identify the annual benefit attributable to

rollover contributions and to immediately distributable amounts transferred from either a defined contribution plan or a defined benefit plan.

III. Comments

A. Definition of Compensation

1. The Treasury should amend proposed § 1.415(c)-2(e)(1)(ii) to delete the requirement that, in order to be taken into account under § 415, compensation must be paid (or treated as paid) to the employee prior to the employee's severance from employment with the employer maintaining the plan.

Proposed § 1.415(c)-2(e)(1)(ii) provides that in order to be taken into account under § 415, compensation must be paid or treated as paid prior to severance of employment. Apparently recognizing that this general rule is too restrictive, the drafters added a series of exceptions:

- A plan may provide that compensation for a limitation year includes amounts earned during the limitation year but not paid during that year solely because of the timing of pay periods and pay dates, provided that (1) the amounts are paid during the first few weeks of the next limitation year, (2) the amounts are included on a uniform and consistent basis in the compensation of all similarly situated employees, and (3) no compensation is included in more than one limitation year;

- Compensation paid within 2-1/2 months after severance from employment does not fail to qualify as compensation merely because it is paid after severance from employment if the post-severance payments (1) would have been made to the employee while he or she continued in employment and are regular compensation for services or (2) are payments for accrued bona fide sick, vacation, or other leave (but only if the employee would have been able to use the leave if his or her employment had continued); and

- Compensation may include payments to an individual who is not currently performing services for the employer by reason of qualified military service (but only to the extent the payments do not exceed the amounts the individual would have received if he or she had continued to perform services with the employer).

As proposed, these rules would also apply to other important sections of the Code. The Treasury has proposed amendments to the regulations under §§ 401(k), 403(b), and 457 that provide that amounts received following severance from employment may be deferred only if they are treated as compensation under the § 415 regulations. *See* Prop. §§ 1.401(k)-1(e)(8), 1.403(b)-3(b)(4)(ii), & 1.457-4(d)(1).

We urge the Treasury to withdraw the proposed rule regarding post-employment payments:

- **There is no statutory basis for the proposed rule.** Code §§ 415(b)(3) and 415(c)(3) define "compensation" broadly. They contain not the slightest suggestion that compensation is limited to amounts paid to an employee while actively employed (or within a short time thereafter).

- **The proposed rule is inconsistent with long-standing Treasury policy.** The Treasury has consistently taken the position that compensation paid after severance from employment is still compensation. *See, e.g.,* Treas. Reg. §§ 1.61-2(a)(1) (treating severance pay, retirement pay, and pensions as compensation), 1.162-27(c)(3) (treating deferred pay as compensation), 1.280G-1, Q&A-11(a) (treating deferred compensation and severance as compensation), 1.415-2(d)(3)(i) (treating amounts received under a non-qualified deferred compensation plan as compensation), 31.3401(a)-1(a)(5), -1(b)(1)(i) (treating deferred compensation as wages).

- **The proposed rule is short-sighted and contrary to the Treasury's long-term interests.** If the Treasury adopts the proposed rule, the rule will be turned against the Treasury in other contexts by those who do not wish to treat deferred payments as compensation.

- **If the proposed rule were the right one, there would be no need for the series of intricate exceptions that the Treasury has proposed.** The acknowledged need for a series of intricate exceptions to the proposed general rule suggests that the proposed general rule might be defective.

- **If it is adopted, the proposed rule will prevent the "safe harbor" definitions of compensation from achieving their objective, causing plans and plan participants to incur substantial additional administrative costs.** The advantage of the "safe harbor" definitions of compensation (*e.g.,* wages for income tax withholding purposes) -- both under the existing regulations and the proposed amendments -- is that employers have systems in place that give them the information they need to apply the definitions. If the proposed rule is adopted, employers' existing systems will have to be revamped since existing systems do not distinguish between payments made before and after severance from employment and do not draw the distinctions between types of payments that are drawn by the proposed regulations.

- **The proposed rule invites evasion.** In the case of severance pay, for example, employers can circumvent the proposed rule by making severance payments immediately before (rather than after) severance from employment or by carrying departing employees on their active payroll for longer periods of time. A rule that invites evasion, as the proposed rule does, is not a good rule.

2. **If the Treasury does not accept the preceding comment, the Treasury should at least amend proposed § 1.415(c)-2(e) to provide that the exclusion from the regulations' definition of compensation for amounts paid after severance from employment does not apply to amounts received by an employee before the end of the limitation year in which the employee severs from employment.**

As explained in the preceding comment, the Treasury's proposed rule will prevent the "safe harbor" definitions of compensation from achieving their objective and will cause plans and plan participants to incur substantial additional administrative costs. The advantage of the "safe harbor" definitions of compensation (*e.g.,* wages for income tax withholding purposes) -- both under the existing regulations and the proposed amendments -- is that employers have systems in place that give them the information they need to apply the definitions. If the Treasury's proposed rule is adopted, employers' existing systems will have to be revamped since existing systems do not distinguish between payments made before and after severance from employment and do not draw the distinctions between types of payments that are drawn by the proposed regulations.

Accordingly, if the Treasury does not accept our first comment, it should at least adopt a rule that not only has statutory support but is also far more administrable and consistent with the "safe harbor" definitions of compensation than the rule that the Treasury has proposed. Because §§ 415(b)(3) and 415(c)(3)(A) refer to compensation for a "year" or "years," they support taking into account all compensation received during the year of severance, rather than the more limited (and less easy to identify) categories of compensation covered by the proposed rule. Moreover, because most limitation years are calendar years, and employers determine their employees' W-2 income on a calendar-year basis, employers would have the data required to implement the rule that we suggest.

3. **The Treasury should amend proposed §§ 1.415(c)-2(c)(1), -2(d), and -2(e)(3)(iii) to clarify the circumstances in which amounts received by an employee under a nonqualified deferred compensation plan are treated as compensation for purposes of § 415.**

Proposed § 1.415(c)-1(c)(1) lists a number of items that are not included in compensation (*e.g.,* items that receive special tax benefits), and provides that although distributions from a deferred compensation plan (whether or not qualified) are generally *not* considered to be compensation for § 415 purposes, a plan *may* provide that amounts received by an employee pursuant to an unfunded nonqualified plan *are* treated as compensation in the year actually received.

By contrast, proposed § 1.415(c)-2(d)(2) states that, in order to be covered by the "simplified" safe harbor definition of compensation, a plan must exclude *all* of the items listed in paragraph (c) (summarized in the preceding paragraph) -- thereby suggesting that nonqualified deferred compensation must be excluded from this definition of compensation.

On the other hand, proposed § 1.415(c)-2(e)(3)(iii) states flatly that deferred compensation paid within 2-1/2 months after severance from employment is not compensation for § 415 purposes (*apparently even if the deferred compensation is paid in accordance with a fixed schedule (i.e., regardless of the employee's severance from employment)).*

We offer the following recommendations:

- **The suggestion made by proposed § 1.415(c)-2(d)(2) -- that nonqualified deferred compensation must be excluded from compensation under the "simplified" definition of compensation -- is inconsistent with the existing regulations (§§ 1.415-2(d)(10) & 1.415-2(d)(3)), is *not* a simplification, might have been the result of a drafting error, and should be eliminated.**

- **Proposed § 1.415-2(e)(3)(iii) should be clarified to provide that deferred compensation paid within 2-1/2 months following severance from employment *is* included in compensation if it would have been paid in the absence of a severance from employment (*e.g.*, if paid pursuant to a fixed schedule).**

4. <u>The Treasury should amend proposed § 1.415(c)-2(f) to delete the requirement that the definition of compensation that a plan uses in applying the § 415 limitations must not reflect compensation exceeding the limit imposed by § 401(a)(17)</u>.

Proposed § 1.415(c)-2(f) provides that because a plan may not base allocations (in the case of defined contribution plan) or accruals (in the case of a defined benefit plan) on compensation in excess of the limit imposed by § 401(a)(17), the definition of compensation that a plan uses for purposes of applying the § 415 limits may not exceed the limit imposed by § 401(a)(17).

This proposed rule is contrary to long-standing Treasury guidance and should be withdrawn. Since at least 1995, the Treasury has stated on a number of occasions that the § 401(a)(17) limit does not apply to the percentage-of-compensation limitations imposed by §§ 415(b) and 415(c):

> "**The percentage of compensation limitations of IRC 415(b) and IRC 415(c) are based on the actual IRC 415(c)(3) compensation, without regard to the IRC 401(a)(17) compensation limit.** However, the benefits and contributions to which the IRC 415 limits are applied cannot be based on compensation in excess of the IRC 401(a)(17) compensation limit." (Emphasis added.)

IRM 7.7.1 (6.3.2(4)) (March 11, 1998); *see also* IRM 7.7.1 (7.5.2(3)) (March 11, 1998); Announcement 95-99 (Nov. 25, 1995) (Examination Guidelines § III.C).

Moreover, the § 415 limits and the § 401(a)(17) limit operate differently. Under § 415(f), the § 415 limits generally apply on an aggregated basis to separate plans maintained by an employer and related entities. In addition, the proposed regulations provide that each aggregated plan must satisfy the § 415(b) compensation limit based solely on compensation with respect to periods of active participation in that separate plan. *See* Prop. § 1.415(f)-1(d). By contrast, the § 401(a)(17) limit is generally *not* applied on an aggregated basis -- making it awkward and inappropriate to link the two limits.

The Treasury's proposed position will hurt older employees the most. The proposed position will cause § 415's percentage of compensation limit to apply to a larger population of employees, and if the proposed position is adopted, many of those who wish to engage in phased retirement or to defer retirement until after age 65 will find that the percentage of compensation limit will prevent plans from increasing their normal retirement benefits sufficiently to avoid an impermissible forfeiture under § 411(a). To avoid impermissible forfeitures, plans will be required either to commence paying benefits at normal retirement age (contrary to many employees' wishes) or to suspend the payment of benefits in accordance with § 411(a)(3)(B) (a complex and burdensome task).

Congress has amended § 415 on numerous occasions. *See* 70 Fed. Reg. at 31,215-16 (listing amendments). At no time did Congress revise, or express the slightest doubt about, the Treasury's published interpretation of § 415. In view of this history of Congressional action, the position taken by the Treasury in the past must be regarded as authoritative. Having received Congressional approval, the position taken by the Treasury can now be overruled only by Congress; it cannot be changed by regulation.[3]

5. <u>The Treasury should amend proposed § 1.415(c)-2 to provide clear, consistent, and appropriate treatment of nonresident aliens</u>.

The proposed regulations fail to incorporate a provision of the current regulations that addresses the treatment of compensation paid to nonresident aliens. Proposed § 1.415(c)-2(d)(3) (the W-2 safe harbor definition) retains the provision in the current regulations that disregards any rules based on the nature or location of the employment, but a parallel provision has been dropped from proposed § 1.415(c)-2(d)(4) (the withholding safe harbor).

[3] "Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change [citations omitted]. So too, where, as here, Congress adopts a new law incorporating sections of a prior law, Congress normally can be presumed to have had knowledge of the interpretation given to the incorporated law, at least insofar as it affects the new statute." *Lorillard v. Pons*, 434 U.S. 575, 580-81 (1978). "A regulation may have particular force if it is a substantially contemporaneous construction of the statute by those presumed to have been aware of congressional intent." *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 477 (1979).

Proposed § 1.415(c)-2(g)(5) includes a special rule for foreign compensation, but the rule applies only to compensation covered by paragraphs (b)(1) and (2) rather than to all of paragraphs (b) and (c). Moreover, because this special rule is based on the definition of foreign earned income in Code § 911, which applies to U.S. citizens and residents, the scope of the rule is unclear. *See* § 911(d)(1). If the Treasury intends § 1.415(c)-2(g)(5) to apply to nonresident aliens, the Treasury should make this clear.

The Treasury should revise the proposed regulations to provide clear, consistent, and appropriate treatment for nonresident aliens under *all* of the alternative definitions of compensation that the regulations allow.

B. Defined Benefit Plan Limits

1. <u>The Treasury should amend proposed § 1.415(b)-2 to provide greater flexibility in applying the § 415(b) limits to a participant who receives plan distributions prior to either an increase in his or her accrued benefit or a subsequent annuity starting date</u>.

Proposed § 1.415(b)-2(a)(3)(i) provides that where a participant has received one or more distributions before a current accrual or before the annuity starting date for a currently payable distribution, the annual benefit that is subject to the limits imposed by § 415(b) is equal, in general, to the sum of:

(a) The annual benefit based on the accrued benefit for which distribution has not yet started;

(b) The annual benefit based on the accrued benefit that started to be distributed in the current year;

(c) The annual benefit based on the remaining amounts payable under any distribution that started in a prior year; and

(d) The annual benefit attributable to prior payments.

The proposed regulations adopt an overly complex and restrictive approach. If adopted, the proposed approach will limit a plan's ability to allow form of payment changes and will be particularly problematic for plans with phased retirement features and other plans that allow participants to have multiple annuity starting dates. The proposed approach is also troublesome for aggregated plans when benefits start at different times and for single plans with benefit options that apply to only part of a participant's benefit (*e.g.*, where the participant's total benefit is the sum of the benefits provided by two formulas and an early distribution is available under one formula but not under the other). In addition, the proposed rule may discourage a plan from offering COLAs because of the risk of an inadvertent violation of the § 415 limits where the only known information about the plan's list of retirees is the name and address of each retiree and the amount and form of each retiree's benefit.

To address these problems, we make the following recommendations:

- **The regulations should offer a number of optional approaches and require a plan to comply with only one of them.** The regulations should recognize that the text of § 415(b) does not prescribe any particular method of treating participants with multiple annuity starting dates, that the calculations involved are complex, that many of the affected plans are complex, that some plans do not have the data needed to make the calculations required by some methods, and that because of the restrictions imposed by §§ 401(a)(4) and 401(a)(17), the § 415(b) limits now affect very few participants in major employer defined benefit plans. Under these circumstances, the regulations should not prescribe a one-size-fits-all approach.

- **The regulations should allow a plan to allocate the § 415(b) limits on a proportionate basis.** For example, if a participant's first form of distribution represented 40% of the § 415(b) limit at the time it commenced, the participant's second form of distribution could not exceed 60% of the then-applicable § 415(b) limit (taking into account intervening COLAs and statutory increases) at the participant's second annuity commencement date.

- **The regulations should exempt broad-based ad hoc COLAs from compliance with § 415(b) and § 401(a)(17).** If adopted in their current form, the proposed regulations will discourage plans from providing COLAs; the exemption in proposed § 1.415(d)-1(a)(5) is so narrow that most plans will not be able to (or wish to) use it. The regulations should exempt post-retirement benefit increases from §§ 415 and 401(a)(17) as long as the cumulative increase in the retired participant's annual benefit (after taking into account any prior increases) does not exceed the cumulative increase in the CPI since the participant's annuity commencement date.

- **The regulations should allow a plan to determine the present value of the permissible distributions at any particular time as the present value of the payments properly permitted under § 415 as of the first annuity starting date, increased to reflect subsequent COLAs and any statutory increases in the § 415(b) limits permitted to apply to participants already in pay status (such as the increases made by EGTRRA) if the plan has been amended to incorporate those increases.** The methodology used by the proposed regulations can cause the benefits that a plan may provide to a participant *to be reduced*. Section 415(b) should not have this effect just because a participant has more than one annuity starting date. For example, distributions commencing between ages 62 and 65 that do not exceed the § 415(b) limits that apply to distributions commencing at those ages should not cause § 415(b) to limit the amount of any additional distributions that commence at or after age 65; if a life annuity of $160,000 per year begins at age 62, and is adjusted to $165,000 per year at age 64 and to $170,000 per year at age 66, the maximum present value of this distribution at age 66 should include the value of each of these payments, not just the value of the $170,000 annuity (plus the actuarial increase from age 65 to age 66) at age 66.

- **The regulations should allow the present value of a distribution to be determined on the basis of the applicable interest rate at the annuity starting date for that distribution.** If the applicable interest rate is 5% in year 1 and 6% in year 10, a distribution with an annuity starting date in year 1 should not have to be re-evaluated, based on the applicable interest rate in year 10, for purposes of applying § 415(b) to a distribution with an annuity starting date in year 10.

- **The regulations should allow a plan to make an interest-only adjustment to determine the size of the offset against the § 415(b) limits to reflect the value of the plan's prior distributions to the participant.** Adjusting for interest (but not for mortality) is consistent with proposed §§ 1.415(b)-1(a)(4), -1(d), & -1(e), which allow a plan to make interest-only adjustments to the § 415(d) dollar limits for distributions commencing before age 62 or after age 65 (as long as the plan does not charge participants for QPSA coverage).

- **The regulations should clarify that the maximum benefit limits apply on the basis of the dates on which payments are due, not on the basis of the dates when payments are actually made.** The regulations should clarify that § 415(b)'s treatment of a corrective distribution under a defined benefit plan is consistent with § 415(c)'s treatment of a corrective allocation under a defined contribution plan. *See* Prop. § 1.415(c)-1(b)(6)(ii)(A). For example, if a distribution from a defined benefit plan is delayed due to an administrative error or due to a delay in distributing a notice to a participant, the delayed distribution should be allocated to the limitation year in which the distribution was due, not the year in which the distribution is actually made. Any interest that is added to a late distribution should be disregarded altogether. The interest is not an additional plan benefit; it merely compensates the participant for the delay in distribution. This treatment is analogous to the treatment of any investment gains that are taken into account in determining the amount of a corrective allocation under a defined contribution plan. *Id.* See Comments B.2 and B.3, below.

2. <u>The Treasury should amend proposed § 1.415(b)-1(a)(1) to provide that § 415(b) limits the benefit accruals, rather than the benefit payments, under a defined benefit plan</u>.

Proposed § 1.415(b)-1(a)(1) states that a defined benefit plan fails to satisfy the requirements of § 415(a) for a limitation year if, during the limitation year, *either* the annual benefit accrued by a participant *or* the annual benefit payable to a participant exceeds the limits prescribed by § 415(b).

The proposed "either/or" rule is contrary to the statute, its legislative history, and existing regulations. Section 415(a)(1) states that a defined benefit plan may not "*provide for*" the payment of benefits that exceed the limitation imposed by § 415(b). Section 415(b), in turn, states that a participant's benefits exceed the § 415(b) limits if "*when expressed as an annual benefit*" the annual benefit exceeds the lesser of a dollar limit or a percentage of compensation limit. Likewise, the legislative history of § 415 makes it evident that because § 415(b) limits a participant's accrued benefit under a defined benefit plan, Congress "grandfathered" benefits that employees had already accrued when the § 415 limits were added to the Code and when those limits were later reduced. *See, e.g.,* H.R. (Conf.) Rep. No. 1280, 93d Cong., 2d Sess. 347-48 (1974); H.R. (Conf.) Rep. No. 841, 99th Cong., 2d Sess. II-474 (1986). Similarly, the current regulations under § 415 provide that, in order for a plan to comply with § 415(b), the annual benefit "to which a participant *is entitled at any time*" may not exceed the limits specified by § 415(b). *See* Treas. Reg. § 1.415(b)-3(a)(1).

Moreover, the regulations under § 401(a)(4) take it as a given that § 415(b) governs benefit accruals. The regulations provide that a participant may be deemed, for § 401(a)(4) testing purposes, to accrue benefits exceeding the § 415(b) limits:

> "For purposes of determining accrual rates under this paragraph (d), plan benefits are generally determined without regard to whether those benefits are permitted to be paid under section 415. However, plan provisions implementing any of the limits of section 415 may be taken into account in applying this paragraph (d) if the plan does not provide for benefit increases resulting from section 415(d)(1) adjustments for former employees who were employees in a plan year in which such plan provisions were taken into account in applying this paragraph (d). If the limits of section 415 are not taken into account in testing the plan for the current plan year, but were taken into account in testing the plan for the preceding plan year, any resulting increase in the accrued benefits taken into account in testing the plan is treated as an increase in accrued benefits during the current plan year." Treas. Reg. § 1.401(a)(4)-3(d)(2)(ii)(B).

In view of the statutory text and the legislative and regulatory history, the Treasury does not have the authority to promulgate the rule it has proposed. Only Congress can make this change.[4]

3. <u>The Treasury should amend proposed § 1.415(b)-1 to add rules for corrective distributions from defined benefit plans that are comparable to the rules in § 1.415(c)-1(b) for benefit restorations and corrective contributions under defined contribution plans</u>.

Proposed § 1.415(c)-1(b)(2)(ii) excludes from the definition of "annual additions" to a defined contribution plan the restoration of an employee's accrued benefit by the employer in accordance with § 411(a)(3)(A) or § 411(a)(7)(C) and restorative payments made to restore losses to a plan resulting from fiduciary conduct that creates a reasonable risk of liability for breach of fiduciary duty under Title I of ERISA.

The Treasury should amend proposed § 1.415(b)-1 to add similar rules for corrective distributions from defined benefit plans. For example, when a defined benefit plan makes a distribution to a retiree to make up for a previous underpayment of benefits (plus interest in some cases), the payment should not be treated as an additional benefit under the plan. The corrective payment merely compensates the retiree for the prior underpayment, and any interest that is included in the corrective payment merely restores the retiree to the position that he or she would have been in if the correct payment had been made when it was due.

4. <u>The Treasury should amend proposed § 1.415(b)-1 to provide that the applicable dollar limit may not decline on account of the employee's increasing age or service</u>.

Proposed § 1.415(b)-1(d) prescribes a method for reducing the dollar limit under § 415(b)(1)(A) when benefits commence before age 62. Under this method, the dollar limit can actually *decline* as the employee continues to work.

We are not aware of any evidence to suggest that Congress intended this surprising result. Although there are doubtless a number of ways of preventing this result, one way would be to amend the regulations to provide that the age-adjusted dollar limit under § 415(b)(1))(A) will not be reduced on account of increasing age or service. *Cf.* § 411(b)(1)(G).

5. <u>The Treasury should amend proposed § 1.415(d)-1(d) to make clear that its conclusion -- that a pattern of repeated plan amendments to reflect increases in the § 415(b) limits pursuant to § 415(d) does not create a § 411(d)(6)-protected right to future increases in the § 415(b) limits -- illustrates the generally applicable rule that a</u>

[4] See footnote 3, above.

pattern of repeated plan amendments that create additional benefit accruals does not create a § 411(d)(6)-protected right to additional benefit accruals.

Proposed § 1.415(d)-1(d) provides that because a participant's accrued benefit can reflect increases in the applicable § 415 limits only after those increases become effective, a pattern of repeated plan amendments increasing annual benefits to reflect the increases in the § 415(b) limits in accordance with § 415(d) does not provide any protection under the anti-cutback rule of § 411(d)(6) for future increases in the § 415(b) limits pursuant to Treas. Reg. § 1.411(d)-4, Q&A-1(c):

> "Thus, a plan does not violate the requirements of section 411(d)(6) merely because the plan has been amended annually for a number of years to increase annual benefits to reflect the increases in the section 415(b) limitations pursuant to section 415(d) and subsequently is not amended to reflect later increases in the section 415(b) limitations."

The Treasury should amplify on this statement to make it clear that this statement is not a limited exception from the anti-cutback rule for adjustments to the § 415(b) limits, but rather a straightforward application of the general rule that a pattern of repeated plan amendments that create additional benefit accruals does not create a § 411(d)(6)-protected right to additional benefit accruals. This follows from two related points that are recognized by Prop. § 1.415(a)-1(d)(v)(B):

- A participant's accrued benefit for purposes of § 411 does not reflect increases in the § 415 limits for any period before the increase becomes effective (*see Feichtinger v. Commissioner*, 80 T.C. 239 (1983)); and

- Accordingly, a plan amendment does not violate § 411(d)(6) (*i.e.*, the amendment does not reduce an accrued benefit) merely because the amendment eliminates a plan provision that incorporates by reference increases under § 415(d) with respect to increases that have not yet occurred.

The regulations should make it clear that because the pattern of repeated plan amendments rule applies only to benefits that have already accrued, the pattern of repeated plan amendments rule does not create a § 411(d)(6)-protected right to future increases in the § 415(b) limits *or to any other future benefit increases* (such as future ad hoc benefit increases). A participant's accrued benefit under a plan does not include the right to a benefit that might be added to the plan in the future.

7. The Treasury should amend proposed § 1.415(b)-1(a)(5) to eliminate the double proration of benefits.

Proposed § 1.415(b)-1(a)(5) provides that, for purpose of the 100% of average compensation limit, average compensation is based on the period of 3 consecutive calendar years of service during which the employee was an active plan participant and had the greatest aggregate compensation from the employer and that if the participant had fewer than 3 such years, the 100% of compensation limit is determined by dividing the participant's compensation during the participant's longest consecutive period of employment while a plan participant by the number of years in that period (including fractions of years, *but not less than one year*).

As a result, the § 415(b) limit for a participant with less than a year of service that is counted under § 415(b) will be prorated for *two* reasons: (i) the participant's compensation (because of the one-year minimum rule described in the preceding paragraph) and (ii) the participant's service (because of the 10-year rules in § 415(b)(5)). Double proration of a participant's maximum benefit is excessive and should not be required by the § 415 regulations. *Cf.* 29 C.F.R. § 2530.204-2(d) (prohibiting double proration under ERISA).

C. Defined Contribution Plan Limits

1. <u>The Treasury should amend proposed §§ 1.415(c)-1(b)(2)(ii)(A) and 1.415(c)-1(b)(3)(iii) to clarify the definitions of the benefit restorations and repayments that are not treated as annual additions</u>.

Proposed §§ 1.415(c)-1(b)(2)(ii)(A) and -1(b)(3)(iii) provide that annual additions do not include:

- the restoration of accrued benefits by the employer in accordance with § 411(a)(3)(D) (which requires the restoration of benefits previously forfeited by a participant in connection with the participant's withdrawal of benefits attributable to the participant's mandatory contributions to the plan if the participant repays the withdrawal to the plan within a specified time period);

- repayments of amounts described in § 411(a)(3)(D) (see the preceding item);

- the restoration of accrued benefits by the employer in accordance with § 411(a)(7)(C) (which requires the restoration of service previously disregarded as result of a distribution from the plan if the participant repays the distribution to the plan within a specified time period); and

- employee repayments of amounts described in § 411(a)(7)(B) in accordance with § 411(a)(7)(C) (see the preceding item).

Although the foregoing provisions of § 411(a) *allow* a plan to restrict a participant's ability to make repayments (for example, by imposing time limits on such repayments), they do not *require* a plan to do so. The proposed regulation should be revised to state that a restoration or repayment is not treated as an annual addition merely because the plan does not restrict the timing of repayments to the maximum extent that the law allows. A contrary rule would discourage the adoption of benefit restoration and repayment provisions that are favorable to participants.[5]

D. Plan-to-Plan Transfers

1. <u>The Treasury should amend proposed § 1.415(b)-1(b)(3) to treat a transfer of benefits from a transferor defined benefit plan to a transferee defined benefit plan that is not aggregated with the transferor plan under § 415(f) as a transfer of *liabilities* rather than as a transfer of *assets*.</u>

Proposed § 1.415(b)-1(b)(3)(i)(B) states that where there is a transfer of liabilities from one qualified plan to another, and the plans are not required to be aggregated under § 415(f), the benefits associated with the transferred liabilities are treated by the transferor plan as distributed in a single-sum distribution, and no adjustment is made to reflect the transfer for purposes of determining the annual benefit under the transferee plan.

Under proposed § 1.415(b)-1(b)(3)(ii)(A), the amount of the distribution is the amount of the transferred assets (other than any "surplus assets" that are transferred); for example, where the value of the transferred assets equals or exceeds the present value of the transferred liabilities, the annual benefit attributable to the transferred liabilities "is determined taking into account the entire amount of the liabilities transferred as a single sum distribution."

Under proposed § 1.415(b)-1(b)(3)(ii)(B), where assets attributable to more than one participant are transferred, the assets attributable to each participant (other than any "surplus assets" that are transferred) are determined as the actuarial present value of the straight life annuity that is actuarially equivalent to the amount that the participant would have received if the plan terminated just before the transfer.

We submit that the focus on *assets* in the context of a transfer of *liabilities* between defined benefit plans is misplaced. The benefits that should be assigned to the transferor plan for purposes of § 415 are the *benefits* that accrued under that plan -- not hypothetical lump-sum distributions that the participants would have received if the transferor plan had terminated.

If the objective of the proposed rule is to treat the transferee plan as providing any *unfunded benefits* that were earned under the transferor plan, the cost of achieving this objective is excessive. Implementation of the proposed rule will be extremely cumbersome and costly since it will require plan termination calculations to be performed for each participant whose benefits are transferred. If it is adopted, the proposed rule will have the undesirable effect of discouraging plan mergers and plan-to-plan transfers involving under-funded plans -- thwarting efforts to improve pension funding and pension portability.

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[5] Similar changes should be made to Prop. § 1.415(b)-1(b)(2)(ii)(C) & (D).

2. <u>The Treasury should amend proposed § 1.415(b)-1(b)(3) to address the treatment of multiple employer plans that are involved in plan-to-plan transfers</u>.

Prop. § 1.415(b)-1(b)(3) addresses the treatment of benefit transfers between defined benefit plans and prescribes the rules that apply when § 415(f) requires the transferor plan and the transferee plan to be aggregated and the rules that apply when § 415(f) does not require the plans to be aggregated.

The proposed regulations should also address transfers to and from *multiple employer plans.* Proposed § 1.415(a)-1(e) provides that a single § 415 limit applies to a multiple employer plan (so that a separate limit does not apply with respect to each participating employer). The regulations should address how § 415 applies to a transfer of benefits to a multiple-employer plan from a single-employer plan and to a transfer from a multiple-employer plan to a single employer plan.

3. <u>The Treasury should amend proposed §§ 1.415(b)-1(b)(2)(v) and 1.415(b)-1(b)(3)(iii) to permit the use of realistic assumptions to identify the annual benefit attributable to rollover contributions and to immediately distributable amounts transferred from either a defined contribution plan or a defined benefit plan</u>.

Proposed § 1.415(b)-1(b)(2)(v) provides that the annual benefit attributable to rollover contributions from another qualified plan is determined on the basis of the rules that apply to mandatory employee contributions under § 411(c) if the plan provides for a benefit attributable to the rollover contribution other than a benefit based on a separate account -- regardless of the assumptions used to compute the annuity distribution under the plan. Under the proposed regulation, if the plan provides more favorable factors than those specified in § 411(c), the plan's annual benefit would reflect the benefits exceeding those that would be payable using the factors specified in § 411(c)(3). A similar rule appears in proposed § 1.415(b)-1(b)(3)(iii), regarding transfers of immediately distributable amounts from either a defined contribution plan or a defined benefit plan to a defined benefit plan.

Plans should be permitted to use assumptions that are more realistic than those specified in § 411(c): 120% of the Federal mid-term rate and the § 417(e)(3) interest rate. The § 411(c) assumptions do not fairly reflect the rate of return that a plan is likely to realize on rollover contributions and transfers. We suggest that plans be allowed to use a more realistic rate, such as an annuity purchase rate, instead of the § 411(c) assumptions.

We appreciate the opportunity to submit these comments. If the Treasury has any questions about our comments, or if we can otherwise be of assistance, please let us know.

THE ERISA INDUSTRY COMMITTEE