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SCHEDULE B PROBLEMS

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This workshop will provide an opportunity to present problems encountered in filling out the Schedule B and how to solve them.

- Reconciliation account: Does it really work?
- Current liability calculations
- Suggestions for improvement

MS. BARBARA J. EVERSBERG: I work for the Houston office of William M. Mercer. Our guest speaker, the IRS representative, is Kathy Marticello. Let me explain our format. We're going to start off with Kathy discussing the changes reflected in the 1991 Schedule B from last year. Then we have some prepared questions and answers going through the Schedule B. Finally, we are going to leave time for questions from the audience.

MS. KATHRYN G. MARTICELLO: There may be one change deleting something from the current 1991 Schedule B. There seems to be some dissatisfaction with one of the questions on 1991's Schedule B -- line 6B, which asks for the date of appraisal of certain types of assets. I'd like to just fill you in a little bit on why that question showed up on 1991's Schedule B and what its prognosis is for future years. The question arose because the field exam program was coming across many situations where hard-to-value assets had not been valued appropriately. It was desired, not by the pension actuarial branch, which usually has responsibility for Schedule B questions, but by other parts of the IRS to put a question somewhere that would tighten up on this problem. And so this question somehow ended up on the Schedule B. It might be more appropriate to put the question on 5500, however, right now it is on Schedule B. It may not be on the 1992 Schedule B, but I can't promise that it will be removed. The question asks you for the date of the valuation of certain types of assets. Now sometimes you might have more than one valuation for that type of asset in a year.

What you should do is put the date of the latest valuation, make an attachment, and in the attachment include the dates for valuations of other types of assets listed there. We've been asked what the actuary's responsibility is. Your responsibility, I think, is to certify what the date is. You need to ask what the date is if you don't know what it is. In no way is it intended that you're required to certify as to the quality of the valuation of those assets. There will be an announcement. We have drafted an announcement at the national office explaining some of these points, but it hasn't reached its final form yet.

MS. EVERSBERG: Now we're going to go through the Schedule B from top to bottom. The first item I'd like to discuss is item five which asks, "Has a change been made in funding method for this plan year?" Kathy, tell us about the chances of Revenue Procedure 85-29 being extended. Is it true that the IRS is thinking about reverting to the old system where we had to request a change in funding method?

MS. MARTICELLO: Well, as it stands now on the books, Revenue Procedure 85-29 may only be used for plan years that begin in 1991. For plan years that begin in 1992, you can't use that procedure. As for the IRS, there are a couple of different schools of thought. Let me go into the background of why Revenue Procedure 85-29 exists at all. The true reason for that revenue procedure is just the overwhelming mass of paper that had descended on the pension actuarial branch back about that time. And so this was really an administrative remedy for the IRS. Now when you do something like this, you really can't let it go forever without monitoring what's going on out there. So on one hand it's desirable to give a short extension to 85-29, and that's something that's under consideration now. But on the other hand it's not desired by the IRS to extend it indefinitely because eventually we'll want things to come in so that we can see just what's going on and how people are using 85-29, if there are problems that we should be addressing. I can't really predict whether there will be in the immediate future for sure a short-term extension of 85-29. I think the chances are pretty good that there will be a short-term extension, quickly followed by a revenue procedure that details, the way 80-50 and 80-129 did, reasonable methods that don't have to come in, and then you will have to submit other methods for actual review.

MS. EVERSBERG: Would you say that, even if we did request approval for a change in funding method, that what the IRS is really looking for is to make sure that the funding method is a reasonable method -- that we're doing it correctly, setting up bases -- and that the IRS really is not trying to deny a plan sponsor a particular funding method?

MS. MARTICELLO: I think that's true. In all the years I've been at the IRS, I personally have never actually denied a request for a change in funding method. Many times there has been a conversation with the actuary who submitted the request or a conversation with a prior actuary concerning modifications that come about as part of the request for change in funding method. But there's always been an amicable resolution of any problems. Some of the situations that we need to fix up are as Barbara says where the bases are not properly established for the proper period. A lot of times there are problems with unit credit method where you have projected unit credit and your plan formula doesn't have level percent of pay each year. You may have 1.5% for the first 10 years and then 1% for remaining years. People try to use projected unit credit and just project the whole benefit and do a level normal cost, and that's not appropriate. So things like that we've had to discuss with the actuaries, but I've never actually denied requests.

MS. EVERSBERG: Would the process take about three to six months now if someone needed to request a change in funding method?

MS. MARTICELLO: We would hope so. I would like to think that except for the most complicated cases it should not take any more than six months to get a change in funding method approved.

MS. EVERSBERG: Let's move on to item 6A, which says to enter the most recent actuarial valuation date. Internal Revenue Code Section 412(c)(9) requires a valuation not less frequently than once every year. Is it possible to do a valuation more frequently than once a year?

MS. MARTICELLO: Only if the commissioner specifically tells you that you must. And in my few years of intimate association with the commissioner I can't ever remember him doing so. I think the reason that it may be confusing now is that there was a change. You used to have to do a valuation at least every three years. When the language was changed to require annual valuations somehow all it says now is that you have to do them not less frequently than every year instead of not less frequently than three years. It doesn't mean that you can do them more frequently than annually unless the commissioner so requires.

MS. EVERSBERG: So we do a valuation exactly once a year for clients, right?

MS. MARTICELLO: Right.

MS. EVERSBERG: Let's discuss item 6d on the current liability. Would you confirm that we can change the current liability rate every year as long as we stay within the published corridor, the 90-110% of the four-year weighted average of 30-year Treasury bonds?

MS. MARTICELLO: As long as there's no change from the published position in 90-11, there is absolutely no standard currently applied by the IRS as to which interest rate you choose for your calculation of current liability. As long as the interest rate is in the corridor, it's considered reasonable, and there's nothing to stop you from changing the interest rate as you wish.

MS. EVERSBERG: May we use a different current liability interest rate for different groups of participants?

MS. MARTICELLO: Currently, no. I know that that's the answer because of discussions at the national office, but the only technical support I can give to my answer is that 90-11 and the instructions to the Schedule B specifically say an interest rate. It is the IRS's position that you should not be using more than one interest rate for different pools of participants in the plan. I guess you could use a weighted-average interest rate or something like that.

MS. EVERSBERG: So if we think the best calculation method for a particular client would be to use a different interest rate for retireds than for other participants, we should use some weighted-average rate to get the same answer, is what you're saying?

MS. MARTICELLO: Well, basically, as long as you use one rate within the corridor there really isn't any reasonableness standard applied to it.

MS. EVERSBERG: Item 6f asks for expected benefit payments. That amount is used in calculating the 150% full-funding limit, is that correct?

MS. MARTICELLO: Yes.

MS. EVERSBERG: Would you confirm that any of the following methods could be reasonable methods for determining 6f? First, what about the actual benefit payments for the immediately preceding year? They are not necessarily reasonable, but they could be reasonable in, say, a large case?

MS. MARTICELLO: Before I address myself to the individual scenarios that you raised, I just want to say that, of course, any method of estimating expected benefit payments has to be reasonable within your professional actuarial judgment. There are various ways that you can determine the amount that you think is reasonable. I don't think the way that Barbara just described is on its face unreasonable. Of course, if you had a plant shutdown in the prior year and you had umpteen millions in distributions that year, that would not be reasonable to use that as a proxy for this year. So you have to use your judgment.

MS. EVERSBERG: But in some cases it could. Second, what about 12 times the monthly payments being made as of the valuation date, or third, expected payments incorporating mortality, or fourth, fine-tuning that to having an expected lump sum payout for the automatic $3,500 cash out. And so in general there is a variety of ways we could come with that, and each one would have to be tested against the particular circumstances. Is that correct?

MS. MARTICELLO: Yes. Also, in regard to item seven, I just wanted to reiterate that you need to be careful in the amounts that you include in your Schedule B. Both in your value of assets and in line seven, your contributions. You should not be including amounts that have not actually been paid to the trust by the date that the Schedule B is filed. And of course, that means paid in cash. For example, if there were a promissory note made by the employer, you should not include that. You should make sure the contributions are actually made to the trust if you're going to include them in Schedule B.

MS. EVERSBERG: We're going to have some combinations on items eight and nine because that is where we do the accrued liability, the unfunded and the normal cost. As far as participants who have terminated nonvested, it is acceptable to drop from the valuation participants who have terminated in a nonvested status if the plan's experience indicates that there's a very low likelihood that any of these would be rehired and bring past service liability with them. Is that correct?

MS. MARTICELLO: Yes. And you just might want to reference Section 1.412(c)(3)(i)-(c)(3)(iii), that specifically tells you that.

MS. EVERSBERG: But on the other hand, if a plan sponsor has a high termination rate and then has a very high occurrence of rehiring those persons who are nonvested, it is probably not appropriate to exclude them. It would be appropriate to carry some kind of liability for those persons who are not currently employed but are former participants with a likelihood of coming back and bringing with them past service. That is correct, right? So there we have an example of a technique being either appropriate or inappropriate depending on the plan sponsor's experience.

MS. MARTICELLO: Right.

MS. EVERSBERG: Tell us what we should do if we get either a normal cost or an unfunded liability that's negative.

MS. MARTICELLO: We've had some problems with people inquiring, if they use the frozen initial funding method and they come up with a negative normal cost, what should they do? The answer is, it's not really appropriate to have a negative normal cost. What you would do first is attempt to reestablish your unfunded liability using the entry age normal method. You hope you will get a positive unfunded liability in which case you technically have a change in method. So if you're under the automatic 85-29, you've used one of your changes in method and this should help you, your negative normal cost should then be cured. If, however, when you try to reestablish, you can't get a positive unfunded, then what you need to do is go to the aggregate method, and you will have an appropriate cost as long as the present value of benefits is still less than the assets. Of course, under either frozen initial or aggregate you do have to continue to monitor the operation of the full-funding limit using the entry age normal method.

MS. EVERSBERG: When we do our annual actuarial valuations, is it correct or incorrect that we need to have data that have to be as accurate as we would need to do the calculation of a person's accrued benefit?

MS. MARTICELLO: Well, I think if I'm going to give a realistic answer, I have to realize in the real world there's no such thing as perfect data for a valuation. I mean you're not going to go out for every single person who's in your valuation and do the same work on the data that you would do if that individual asked for a quote as to the status of his or her accrued benefit, especially if you have a large plan. However, that doesn't mean that your data should not be as reasonable as they possibly can be. For example, I've seen at least one very large, collectively bargained plan where over 20% of the participants had either an imputed age or an imputed compensation. That's really not appropriate. So it's a question of judgment, and you should be warned that the IRS has upon examination because of data problems required the actuary to go back and refile a Schedule B because with more careful data sometimes funding deficiencies arise retroactively, and they would be subject to excise taxes.

MS. EVERSBERG: Could you give us an example of a bias in the data that would just be inappropriate? I mean something that would be clearly inappropriate in the database.

MS. MARTICELLO: Well, the example we discussed is really more than a data problem. That's where the actuary may be using an estimate for data that doesn't conform to the provisions of the plan. For example, if your plan benefits would be based on your straight time salary plus overtime or plus bonus or plus something else, of course, it has to be nondiscriminatory. And if for purposes of your valuation you use only the salary, you could easily have a problem because you're clearly going to have a bias toward low cost because you're only including the salary rate. So in a case like that there could easily be problems on examination.

MS. EVERSBERG: Okay. We're still on item nine, I'd like you to give us some information on how to correctly do the Schedule Bs when two plans merge. And my understanding is that, if one of my clients has two defined benefit plans and they both have a valuation date of January 1 and they would undergo a merger as of July 1, I would not have to do new valuations as of July 1. I would not be able to just treat this as any amendment that I could just overlook until the following January 1, but I could use the results of my two January 1 valuations and take the appropriate portions of those valuations to get me through to the following January 1.

MS. MARTICELLO: Yes, that's true. I won't go through the gory details of the method of the calculation, but essentially you would take the plan that was disappearing, that was being merged into the second plan. Even though that's not really true. The IRS looks on a merger as really the two plans that are being merged are extinguished and there's a new entity that's being formed. But in any case, for the year of the merger for the plan that you assume is merging into the second plan, you calculate your costs based on a short-plan-year-type of calculation, and that would be one of your costs. Then for the plan that is being merged into, you would calculate your funding requirements in two pieces. Piece number one, the plan that's being merged into, would be the normal costs, the regular calculations for the full plan year for that plan. Piece number two would be the rest of the annual cost of the plan that was merged into that plan, basically on a pro-rata basis. Now many people ask, what if the two plans have different funding methods and have different assumptions? That's okay. You can still do this type of combined calculation even if the numbers are coming from different places. However, once you get to the next plan year, you will need to have a change in funding methods so that the plan is now one single funding method, and you will need to make sure that all of your assumptions are standardized for the on-going plan. So you don't need to worry until the second year.

MS. EVERSBERG: Item 9f talks about additional interest charge due to late quarterly contributions. So I'd like to ask some questions about the quarterly contributions. Is it true we can use a credit balance to pay off our quarterly contributions and that a credit balance would get interest up to the date that the quarterly is due?

MS. MARTICELLO: Yes, that's true. Look at notice 89-52 which deals with quarterly contribution requirements. A credit balance, of course, it has to be a credit balance as of the end of the prior year, and it has to be a bona fide credit balance. In other words, it can't be based on amounts that have not yet been contributed. So if you're using a credit balance as of the end of the prior year to satisfy your quarterly contributions for this year, when you come to the first quarterly contribution, if you have not yet made contributions that are going to be due September 15 or so, you shouldn't include those in your credit balance when you take it down to pay your quarterlies. You can credit the credit balance with interest until the date that you debit the credit balance for the quarterly contribution.

MS. EVERSBERG: I have another question on quarterly contributions. I believe you and I discussed three possible scenarios for a plan sponsor that missed a quarterly contribution. One would be that the sponsor would have an extra interest charge. A second would be that in the year for which the contribution is due the sponsor hits the traditional full funding, and therefore the total amount of contributions would not be any greater. So there would be no additional contribution required even though that plan sponsor had missed a quarterly contribution. And the third case would be that the plan sponsor hit the 150% current liability full funding, and in that case there'd be no additional funding required in that year because the total amount of contributions would be limited, but that would have an effect on future years. Is my understanding correct, or do you need to straighten me out?

MS. MARTICELLO: That's correct. And the reason it would have an effect on future years if you only hit the 150% full-funding limit is, even though in the current year your contributions are limited, you get a full-funding credit for everything above what you need to contribute above the full-funding limit. That credit becomes a 10-year amortization base in the subsequent years' Schedule B. And if you miss your quarterlies and you have an interest penalty, then the full-funding credit is going to be bigger, and you could end up amortizing it beginning in the subsequent year unless you hit your accrued liability full-funding limit.

MS. EVERSBERG: On number 9k, we credit interest on the contributions. Well, we credit interest on h, i and j, and part of that is the contributions. Do we have to use simple interest or compound interest, or do we have our choice on that?

MS. MARTICELLO: Anything your heart desires as long as it's reasonable.

MS. EVERSBERG: There was a time when people used to credit interest for the entire month if that contribution was made before the 15th. Has there been a change in thinking on that now that we've put the entire date under item seven?

MS. MARTICELLO: Yes. In Schedule Bs for prior years the only thing that was in item seven was month and year. Now there's month, day and year. So I think it probably is appropriate to credit the interest from the actual date that the contribution is made. But you do have your choice as to method of crediting the interest.

MS. EVERSBERG: Simple or compound. And we don't have to let leap year bother us a lot.

MS. MARTICELLO: Not unless you're Sadie Hawkins.

MS. EVERSBERG: But we should be doing it to the nearest day now that we all have calculators and computers.

MS. MARTICELLO: Right.

MS. EVERSBERG: The reconciliation account item 9p, would this be wiped out if a plan hits the full-funding limit? Assuming we have one, we have real entries in our reconciliation account.

MS. MARTICELLO: Well, it's a little bit tricky. The reconciliation account is wiped out only if you hit the accrued liability full-funding limits. So that's what you have to remember. Some things are wiped out only if you hit the accrued liability full-funding limit. They are wiped out; you just have to be careful you got the right full-funding limit.

MS. EVERSBERG: If our funding method is the aggregate funding method, would we subtract the reconciliation account from the assets like we do with a credit balance?

MS. MARTICELLO: Well, if you're using the aggregate method, in general, it's appropriate to adjust your assets for things that are arising that are really not related to changes in your liabilities or your assets. An example would be waiver basis.

Now there has been some discussion at the national office and any of you who attended the enrolled actuaries meeting probably were treated to a difference of opinion between the practitioner who gave a presentation on Schedule B in the morning and Jim Holland who gave a presentation on Schedule B in the afternoon. There's even not full agreement among the actuaries at the national office. If you subtract the reconciliation account balance from your assets the way you would subtract a credit balance, then your normal cost will be smooth. Your normal cost will be more consistent between the aggregate method and frozen initial liability method. One of the desired objects of the funding regulations is that you have a smooth normal cost. However, the argument the other way is that the reason you subtract the credit balance from your assets is to avoid duplication. And the credit balance gives you duplication in that the amounts you contributed over and above what you needed to contribute have reduced your assets and thus reduced your unfunded. You also have that little piece in your Schedule B that is the credit balance that you can apply to satisfy future requirements. Now the reconciliation account balance isn't anything in anybody's pocket. You certainly can't use it like a credit balance to pay for anything. So you don't need to treat it the same way that you need to treat a credit balance. The short answer is that I don't know the answer. And that anything that you do that you feel is reasonable at this point in time I think would probably be appropriate until the IRS actually publishes something telling you what should be done, and I think once something is published it would be on prospective basis.

MS. EVERSBERG: Item 10 talks about the alternative minimum funding standard account. And of course, you have to be using the entry age normal cost method as your funding method to even become eligible to think about item 10. But let's say that is the case.

MS. MARTICELLO: For at least five years.

MS. EVERSBERG: Right, we're using the entry age normal cost method for at least five years. Our cost method is the entry age normal cost method and has been so for five years. There were some proposed 412 regulations that say that to use item 10 you have to use the PBGC graded rates. Is there any news on this? Is this still the case?

MS. MARTICELLO: Well, I don't think it's necessarily the case. There's also a regulation under Section 414(l) that talks about assumptions that are reasonable for purposes of calculating amounts in a spinoff. Those regulations say that PBGC rates will be considered reasonable for that purpose. And now recently when we've been doing rulings on mergers, because the interest rates in the current liability corridor are supposed to roughly mirror interest rates that are available as annuity purchase rates in the marketplace, we have been permitting spinoff calculations based on rates within the current liability corridor, even if they give a smaller amount than you would get using the PBGC graded rates. I think a similar answer might be appropriate for the alternate funding standard account. In any case there is nothing in writing that specifically mandates any interest rate that has to be used to calculate present value of accrued benefits for the alternate standard account. There is only a proposed regulation and of course, a proposed regulation doesn't need to be followed. So if you wish, I think it would not be unreasonable to use a rate within the current liability corridor for that calculation. Not saying that you could be quite as loose as to use any rate in the corridor. You might want to balance what's available to that plan in the annuity purchase market. For example, if it's a large plan, you might be able to get a different interest rate from an insurance company than if it's a small plan, etc. So it can be anything reasonable.

MS. EVERSBERG: Now that we have the interest assumption down, when we're using the alternative minimum funding standard account, may we use termination decrements to calculate the normal cost and may we use the plan's early retirement decrements or do we have to use the most valuable approach as if the plan terminated and the employer shut down?

MS. MARTICELLO: I don't think there's any requirement to use the most conservative approach. If I understand what you mean, if there's a contingent benefit in the plan for early retirement and an individual doesn't have the service yet, would you have to assume the person will get the service? That's not required, but you would need to use your ordinary valuation assumptions to estimate with some sort of reasonable turnover assumption whether the individual would ever be entitled to that subsidy or not. It should be included, but doesn't have to be on the most conservative basis.

MS. EVERSBERG: Now we'll move to the famous 12h. Estimated investment return on actuarial value plan assets and the instructions have a formula on how we're suppossed to do that. There is 2*I* over *A* plus *B* minus *I*. I think I know what A and B in the formula mean. I'd like to ask a question about the big *I*. Is this the total of the investment income on the form 5500? Does that have to be what big *I* is?

MS. MARTICELLO: Not necessarily. But I would assume that it would be something quite close. For example, if there was a change of investment vehicle, it would be legitimate to decrement *I* by the financial managing costs of changing the investments. However, some people have asked whether it is permissible to decrement *I* by fees, actuarial fees, for example. And the answer to that question is no. Expenses like fees that are paid to the actuary or to any other individual servicing the plan are not an appropriate decrement against the investment income. It's a distribution. It's like a distribution from the plan except you're giving it to a service provider under the plan. So you shouldn't take that out.

MS. EVERSBERG: If our *I* doesn't agree with the 5500 but we do remove these expenses that are related to investment, should we add some kind of note or is someone at the IRS checking that we used this formula correctly?

MS. MARTICELLO: It's not really a crime to give the wrong answer in miscalculation. There are more serious crimes that carry more serious punishments than this mistake. But it's on there just to give a rough idea of what investment earnings were. So it is to simplify things so that there's just some reference point. It's obviously not going to be absolutely right because it assumes the contributions and distributions are made in the middle of the year. Many plans at least in prior years' contributions weren't made until well after the end of the plan year. So if this *I* is not correct, the worst that can happen is, it will be incorrect in such a way that it will make someone question your investment assumption. But if that should happen, then this certainly doesn't bind you in any way. There would be an investigation as to what your actual investment earnings really were. And if it makes you feel more comfortable, there's no reason that you have to use this formula. You can attach a statement to the Schedule B using a formula that you think is more accurate and comes up with a different answer, no problem.

MS. EVERSBERG: So what you're really saying is we have to fill out 12h, but we can put another calculation?

MS. MARTICELLO: Right.

MS. EVERSBERG: Okay. We have to do 12h the way the formula says, but if we're very unhappy with that, we add an additional piece of information. Item 13 concerns the additional required funding charge. I'd like to focus on 13e the outstanding balance of the unfunded old liability. Is it correct or incorrect that, if on a valuation date our current liability is less than the assets, that wipes out any old unfunded liability we might have?

MS. MARTICELLO: That is correct. Once your unfunded current liability is zero, then your old unfunded goes away. Now sometimes you can be in between where your unfunded current liability is not zero. However, your unfunded old liability minus your unfunded current liability minus the outstanding balance of your old unfunded is zero or less than zero. In that case you should maintain your old unfunded. You wouldn't have any amount due for your new current liability unfunded, and the amount that you contribute would be limited so that you would never have to contribute more than is required to bring your current liability up to the amount of your assets.

MS. EVERSBERG: I don't have any more questions on the form itself. I'd like to ask some questions on what we do if our plan sponsor freezes its plan. Let's say that my client freezes the plan as of December 31, and I do not have an automatic change of funding method available to me. Would the IRS approve a request from me to change to the unit credit method in that situation?

MS. MARTICELLO: Well, I think probably, let me go back and just clarify if I may my understanding of what's behind the question. You can freeze your plan, where it's a true freeze. I'm talking about a true freeze now where you don't have any compensation increases continuing, this is it. This is your accrued benefit. If you have a funding method that would in some way give you a nonzero normal cost, for example, if you have the entry age normal funding method and somehow your plan is not fully funded, it's possible you could come up with a positive normal cost with your present value benefits, entry age, etc. Now if your plan is frozen and there really is no future service benefit anymore, all of your benefits are essentially past service benefits. Then in order to have a really appropriate allocation of your liabilities you should not be allocating liabilities to future years. So not only would the IRS approve a change to the unit credit method in that situation, but also I think you probably should change your method to the unit credit method so that you no longer have a nonzero normal cost while you're in that situation.

MS. EVERSBERG: And while I'm asking for the approval to change to the unit credit, I can ask for a change in that part of the funding method that includes whether or not we recognize mid-year amendments. Is that correct or incorrect?

MS. MARTICELLO: Yes, the way you recognize amendments is part of your funding method, but of course, I guess that, from some people's point of view, that's the least of everybody's problems. There seems to be some controversy about how mid-year amendments work these days. For example, if you would amend your plan in the middle of the year under Section 412(c)(A), you can make an election to take that amendment into account for that plan year for purposes of funding. If you wish to do that, there is still a section in the temporary regulations that says in detail exactly how you're supposed to file this election. Those temporary regulations are still on the books. There are proposed funding regulations under 412 that sort of eliminate some of the detail. But those proposed regulations do not override temporary regulations. So if you wish to take an amendment that's made during a plan year or within two and a half months after the end of the plan year into account, you should formally elect to do that, and you should look in the temporary regulations to see exactly how you should elect to do that. Now I'm not saying that a disaster is going to happen to you if you don't but it is a technical requirement and is to serve people in the districts, and the IRS has been known to really be a stickler for this.

Once you've elected to take this amendment into account for the plan year, how do you do it? Then you fall back on our Revenue Ruling 77-2. It depends on the effective date of the amendment, and basically I think our position right now is that we take it into account on a pro-rata basis. Now I'm not talking about the effect of the full-funding limitations coming into play. That's a more controversial position. If you have a plan amendment that's just a plain vanilla plan amendment and that changes your liabilities and you elect to take it into account, then you go to 77-2, and you take it into account on a pro rata basis. If, however, your plan because of the amendment becomes fully funded by the end of the year, whether you are required to do some kind of a pro-rata consideration is really not clear at the moment, and there is discussion at the national office on both sides of that issue. We are hoping to come out with something in the near future that will clarify that problem. Meanwhile, you're just going to have to do the best you can, a reasonable good-faith interpretation.

MS. EVERSBERG: Tell us the bad news that is appropriate in this situation. A client has been fully funded for years. The valuation produced a minimum contribution of zero, and the client decides to terminate the plan and the best annuity quote it can get requires the client to dump money into the plan. The client just can't close out the plan with the assets in the trust. Tell us about that extra contribution, what the plan sponsor has to do with it, or can or cannot do with it.

MS. MARTICELLO: That's a situation where in the year of termination you need to make a contribution to the plan to achieve a standard termination. And a standard termination, of course, means you have to be able to provide all liabilities under the plan from plan assets at the date of distribution. Now the deductible limits under 404 would still apply in the year of termination. You can, of course, deduct, if you have 100 people, all the way up to the value of current liability.

The IRS position is that contribution then becomes deductible over the 10 years subsequent to the plan termination, rateably at 0.1. Essentially it's not exactly clear what interest rate would be used, but I think it would probably be a zero interest rate, and it would be deductible rateably over the subsequent 10 years. However, because you've made a nondeductible contribution, the 10% excise tax in Section 4972 would apply. And unless there's relief it would apply not only in the year that you make the contribution, but also it would apply until you've used up the carryover during the subsequent 10 years. Now before I came to the meeting I looked up a general information letter that has been circulating around recently. The date is October 22, 1990. That general information letter says in general the penalty tax under Section 4972 continues to apply until such time as the excess amount is corrected. However, upon plan termination, the penalty tax under Section 4972 no longer applies. Since there is no longer a qualified employer plan. Well, that's a very nice general information letter. Of course, the last sentence says you can't rely on it. And it might be a good idea not to rely on it because a general information letter doesn't have the authority to change the code. It is definitely a position that the IRS is taking into consideration. And we are working on something to take care of this situation. However it may be that the 10% tax will apply in year of termination, and it is possible it could apply not only in the year of termination but also in the first subsequent year. An example would be if you need to put the money in not during the year of termination but when you make the distribution that wouldn't be during the year of termination. It could be six, seven, eight months later. It's a possibility that contribution could get hit with a 10% tax, too. But you won't know, and I myself don't know what the answer is.

MR. ADAM J. REESE: How do you explain the economic reality of that to a client?

MS. MARTICELLO: That's why I'm glad I don't have to do this. That's why we are trying to work on something that will give some relief.

If you have a situation where the deduction limit of up to the current liability doesn't help you, you could let the plan go another year. In that case, you could get the deduction.

MS. EVERSBERG: Write to your Congressional representatives, they'd love to do something for you this year.

MS. MARTICELLO: I do have one comment about your situation. Let's say it's a small plan. If it's not a title four plan, plans that have guaranteed benefits under PBGC rules, there are exceptions for certain plans that are not covered under title four. Small professional corporation plans with less than 25 people, etc. are not covered under title four. In this case you could terminate the plan in a standard termination without making a contribution without having enough money to fund all benefits. So you could avoid the problem by simply not making a full distribution to the individuals in the plan, or you could terminate the plan and allocate all of the assets first to nonmajority owners and then still have a standard termination without making a contribution. So there are things that you can do. Not palatable things but there are things.

MR. DONALD J. SEGAL: What if the credit balance is increasing solely due to amortization credits? Typically this occurs where you've had a huge gain where you're amortizing over five years. So you technically have a full-funding limitation, but there's no full-funding limitation credits and therefore you don't wipe out any of your bases, etc. What are you supposed to do?

MS. MARTICELLO: When you're in a situation like that, the advice of the IRS used to be that you should combine and offset your bases. Now nobody wants to combine and offset their bases anymore because they need those bases for the deficit reduction contribution offsets. There is nothing technically wrong; the IRS will not do anything to you if your credit balance is increasing merely because of the operation of amortization credits. So you can have a credit balance that is increasing even though it's not increasing because of contributions.

MR. SEGAL: So there's no such thing as a full-funding limitation credit then? Because you don't need it.

MS. MARTICELLO: Well, eventually I would hope you would need it.

MR. SEGAL: It would be at least five years before you needed it?

MS. MARTICELLO: It could be.

MR. ETHAN E. KRA: Going back to the ultimate question where you were dealing with terminating a plan. One proposition that's been put forward, however I understand that some people in the IRS do not agree with it, would be to change the valuation date to the end of the year, the last day of the plan year after all assets have been distributed. So during the year, you make a contribution adequate to wind down the plan and distribute all the assets, and on the last day of the plan year, the valuation date there are zero assets and zero liabilities. However, those assets include contributions that have not yet been factored into the valuation process. So therefore, the assets should really be negative reflecting the contributions made during the year, zero minus the contributions during the year and then in, assuming 100 participants in order to fully fund the current liability requires that full contribution.

MS. MARTICELLO: Wait, wait a minute. I think I'm a little confused. What you wish to do is in the year of termination you wish to change the valuation date.

MR. KRA: To the last day of the plan year. At the date after you've done all the distributions and made the contribution necessary to make the plan adequate.

MS. MARTICELLO: Now for purposes of your funding method you should not include in your assets contributions that are made for the current year.

MR. KRA: Correct. Therefore, I have negative assets. The zero minus the contribution. My current liability is zero. Zero minus the negative number gives me the positive number that exactly equals the contribution I had to make to make the plan sufficient.

Pending issuance of regulations, I think there is a strong argument that can be made. We had a situation where we took over a plan, and in doing so we found in excess of about $1 million worth of liabilities that were not reflected in the prior actuary's reports. He had miserable data. We couldn't accept the credit balances going back to 1976, or the amortization basis. We requested a change in funding method from entry age normal to entry age normal. The individual at the IRS who reviewed it required us to take $100,000 of the difference and amortize it over one year and the balance over 15. Figuring that put the plan where it would have been otherwise.

MS. MARTICELLO: Barbara had asked me some questions, too, about what should you do if you're a takeover actuary and you can't justify some of the things or many of the things done on a prior Schedule B. You have various routes. Yours is the best. When there is a severe problem, you should come in and ask for a change in funding method.

MR. KRA: We were willing to negotiate anything, just tell us what to do so we can sign.

MS. MARTICELLO: Yes. But the least that you should do is to do the best of your ability if you have a situation where you can figure out what your funding bases and your credit balance should have been.

MR. KRA: Impossible.

MS. MARTICELLO: Right.

MR. KRA: And we do 10 years' worth of valuations. What do you do for the aggregate funding method where you have the 10-year base for the full-funding limit?

MS. MARTICELLO: For the current liability full-funding limit?

MR. KRA: Correct.

MS. MARTICELLO: You should adjust your assets.

MR. KRA: You add it to your assets.

MS. MARTICELLO: Well it's like a waiver; it's like all the other bases. There's the short fall base, and there's a switchover base. There are other various bases that should be added to the list.

MR. KRA: Added to the assets, okay. Regarding line 12(h) of the Schedule B, what if the actuarial assests are smoothed. The actuarial value of plan assets that will not match the 5500. If I'm doing a five-year moving average, I would use the return on actuarial assets?

MS. MARTICELLO: Absolutely.

MR. KRA: Not the asset number on the 5500.

MS. MARTICELLO: Absolutely.

MR. KRA: But what about the investment manager fee of the trustee fee which is related to getting that investment return? I don't mean the actuarial fee, but the fees related to generating the investment return.

MS. MARTICELLO: In some cases fees that are associated with attaining the investment return can be taken into account. My example was the easiest one, if there's a charge for selling bonds and buying something else. Now where you're actually keeping an investment manager on payroll, paying him a fee every year just to manage the assets, that gets a little bit iffier. Because actually it's more of an ongoing fee for this individual. I wouldn't want to say one way or the other.

MR. KRA: I think that if you surveyed, you'd find quite a large number of people recognizing that particular one.

MS. MARTICELLO: Oh. I think so. I think there are a lot of people recognizing fees to the actuaries, too.

MR. KRA: That I would question.

MS. MARTICELLO: But you'd have a better chance on that one than the fees to the actuary.

MR. JEFFREY F. HARTMANN: I deal mostly with small plans and it's fairly common that, within the defined-benefit plan, there may be some separate accounts for being maintained for rollovers from prior defined-contribution plans, and I always thought it was proper like in item 6c and 8b for assets and 6d for the current liability to include those rollover amounts in there. I wasn't excluding any part of the plan, but a lot of people told me they thought otherwise, and I wanted to hear what you thought about it.

MS. MARTICELLO: What are you including?

MR. HARTMANN: Well, let's say I had $1 million of assets. And let's say there's $300,000 in rollover accounts and the other $700,000 is funding the defined-benefit plan benefits. So do I include the $300,000 in line 6c and the others?

MS. MARTICELLO: No, I don't believe so, because you really should not be using those assets in your computations for your normal cost and so on for the defined benefit part of your plan. This is because you have another liability that really that offsets these assets, and that liability is what you owe in that separate account. Now it gets a lot trickier if you have a 414(k) plan where you have some people who have converted their plans to 414(k) plans and the defined benefit part of their plan is not fully funded yet. The IRS is looking into issues connected with that, too: funding issues, distribution issues, etc.

MR. HARTMANN: Well, I'm not using those assets, but I read the instructions for line 6c to say in effect the amount on line 6c should match what the 5500C shows as total assets.

MS. MARTICELLO: And those are the assets that you show on 5500C?

MR. HARTMANN: Yes, and the assets might include those rollover accounts, right?

MS. MARTICELLO: Any time you put something on the Schedule B that doesn't match it's an easy trigger for somebody who is screening out a plan to pick up. What I would advise you doing is put a notation on your Schedule B with a little explanation because you're absolutely right. If there are visible differences in the Schedule B, then it is possible that somebody would pick it up. The easiest thing to do is annotate your Schedule B. I mean you can put as much on there as you want. That would be my advice.

MR. ROGER ROSS GRAY: I understood that a year or two ago the IRS's position on quarterly contributions was if they were due on the 15th and the 15th was on a weekend that they had to be made on the weekend. Is that still the IRS's position?

MS. MARTICELLO: I think it's the date due. I'm not as good on the administrative forms and so on as I should be, but there's at least one court case in the past that the IRS lost but it was unagreed. There's a difference between filing a form that's due on a weekend late and making a payment that's due because of filing the form late. The court case specifically dealt with the payment that's due eight and a half months after the end of a plan year. Being late, being whether it could be made, if the date fell on a weekend whether it could be made after that weekend. The court ruled yes it could be. The IRS never agreed with that. I don't think it's actively enforced. But the IRS still feels that any payment is due on the date that it's due, period.

MR. GRAY: Well, I know that a quarterly contribution is a reference back to regulations. But I think the regulation flies in the face of what's in the code.

MR. LLOYD A. KATZ: And my question is regarding the treatment of unpredictable contingent event benefits in the year of their occurrence. For example, you have a client with a January 1, 1991 valuation, you perform the valuation, you finish it let's say by June. And I'm not sure that finishing it is really an important fact. Say you find out in July that the client is closing down a plant, and it's about to pay substantial termination benefits. Those would be unpredictable contingent event benefits. But do they first affect the Schedule B in the 1991 Schedule B, or do they affect the 1992 Schedule B?

MS. MARTICELLO: They've occurred after the valuation date. I would say the 1992 Schedule B.

MR. KATZ: Is there any guidance going to be forthcoming in this area?

MS. MARTICELLO: There is going to be guidance forthcoming in this whole general area. But of course, I can't say when that will be out. If you need an answer, you can either write for general information, you could request a ruling on something like that even.

MR. KATZ: Request a ruling but most likely it would be the following year?

MS. MARTICELLO: Yes.

MR. MAX ROSENBERG: Back to your termination situation, how would you handle it on a Schedule B where you have to make an additional contribution to meet minimum PBGC requirements? This is similar to your annuity situation.

MS. MARTICELLO: You mean the amount that you need to terminate the plan?

MR. ROSENBERG: Right. To satisfy PBGC.

MS. MARTICELLO: Okay. There's a form that you file for PBGC.

MR. ROSENBERG: Right. How would you handle it on Schedule B though?

MS. MARTICELLO: On Schedule B you have, let's take the first case. You never changed your funding method from the prior year.

MR. ROSENBERG: Right.

MS. MARTICELLO: All of your charges and credits are in accordance with your funding method from the prior year. Any requirements that you have on a termination basis to satisfy PBGC are more or less irrelevant from the point of view of what's required in your Schedule B. So the two of them certainly may not be consistent with each other. However, the requirements that your deductions and your requirements for contribution are based on your actual Schedule B requirements. You can change your funding method in the year of termination. You can change the method you use to value your liabilities. You can change the method you use to value your assets. You can change your valuation date. You can change your assumptions used to value your liabilities. There is nothing to stop you from changing your assumptions to value your liabilities to the annuity contract cost of those liabilities on the new valuation date which you automatically make the date of termination or the end of the plan year. So all those things make you a little bit more consistent, but unless everybody takes a lump sum under the plan, you're not going to match PBGC's rules.

MR. ROSENBERG: This is a situation where everyone is getting a lump sum, but how would you show it on the actuarial assumptions? Normally we've had the greater of the present value of accrued benefit or the PBGC lump sum. And how would you show that on your actuarial assumptions on the Schedule B, if that's your basis for your payouts and your final valuation?

MS. MARTICELLO: Well, then we come back to the controversial issue of whether you can automatically assume that somebody's going to take a lump sum and value the lump sum based on the PBGC interest rates. And those issues have come up in the small plan audit program. However, when you value your liabilities for purposes of your underlying funding method, not for purposes of current liability, you should be estimating probable date of exit. You should be estimating probable forms and taking the present value of those. And I don't see anything wrong with changing your assumption to say that XYZ individuals are going to take a lump sum. And the lump sum is what I really have to pay for the lump sum, and this is the value of my liabilities.

MR. ROSENBERG: Is there some way of indicating that on the Schedule B where you show that?

MS. MARTICELLO: Well, those would be your assumptions for your actual funding method. But, you wouldn't be able to deduct all that in one year because you've changed your assumptions. You've increased your costs. But you have to amortize the results over 10 years for purposes of deductions. The only thing you can deduct all in one fell swoop in the year of termination is the amount up to current liability. And you could not take it into account for purposes of current liability.

MR. ROSENBERG: Okay.

MS. MARTICELLO: So you haven't solved the problem, I don't think. You still have that 10-year deduction problem.

MR. CARL W. VOSS: Earlier we brought up the question about the negative amortization that may result from a large gain being amortized over five years. One thought that we had in our office was combining and offsetting bases as you suggested and maybe we don't like to do that because of the deficit reduction. How about combining and offsetting and unbundling as we did in 1989 and breaking them back into offsetable and unoffsetable? They're all being amortized over eight years. We know how much came from each type of amortization base. Would that be okay?

MS. MARTICELLO: Well it would solve your problem; unfortunately I can't give you encouragement in that regard. I think it was a notice that dealt with combining and uncombining bases, specifically with uncombining bases in the 1989 plan year. There has been no permission from the IRS as yet to uncombine bases that were combined afterward. There is a problem with issuing that type of permission in that people will play games. They will combine and uncombine as they wish, and it's just not a tax deduction question; they could do it to the detriment of the PBGC.

MR. VOSS: I think negative amortizations are a detriment to the PBGC.

MS. MARTICELLO: A detriment, that's absolutely true. We have been considering what should be the successor to this notice or whatever it is. And whether under any circumstances there should be permission to go back and forth and what standard should apply. But right now you could not do it.

MR. VOSS: Okay.

MR. RICHARD JOSS: You were talking earlier about mergers, and I just want to clarify one point. Let's say I'm the actuary for the receiving plan in a merger situation. And the plan year is a calendar year and I am a really smart actuary who's got all my work done on February 1. And I learn about this merger which is effective July 1. I believe that under 77-2 I can defer any recognition of that merger until the next plan year?

MS. MARTICELLO: No. A merger is different from a regular amendment under 77-2. The charges and credits to the funding standing account need to be made on a continuous basis. You have one plan where you have the short plan year. You charge continuously to the end of that plan year. There has to be a continuation in that plan somewhere. It appears in the plan into which you have merged that plan, that's in the combined charges and credits for that plan. So you have charges and credits for the big plan that's ongoing for that year. You have the charges and credits for the rest of the year for the old plan. You have a nice continuous situation.

MR. JOSS: Is that written down someplace?

MS. MARTICELLO: It's written in various general information letters. It is not specifically either in 414(l) or anywhere else. I don't know how much people can rely on what's said in enrolled actuaries meetings, otherwise I might be hung. But there are various examples in some of the old sessions. There's one specifically in 1989 where the speaker did three or four examples of what you're supposed to do. So it is IRS policy.

MR. JOSS: I don't want to ask another question but keep in mind that you can tell me what I'm supposed to do. These are clients' plans and the clients are paying the fees. And especially like in the savings and loan situation you have people who have been acquiring little teeny savings and loans at four or five times in a given year. It's one thing to say I need to do something magical at all those various dates. It's another to say, hey, let's glue them all together and start them off with a new plan year.

MS. MARTICELLO: But really the intent of this is to be helpful. Because I mean there could be a requirement that on the date of the merger you have to start all over and you have to have new assumptions and change your method. I mean this is intended to let you finish that year in peace and start a new year on your new basis.

MR. HARTMANN: I have questions about how to deal with short plan years that arise either from changing the plan year or terminating the plan in conjunction with a quarterly contribution requirement. Let's say that the short plan year is four months. I really don't have a clue as to what the accepted method is of computing quarterly contribution requirements.

MS. MARTICELLO: Well, I think that there are really two ways you could go. If you look at the hard code, I believe it says that you're supposed to have four payments in a year. So if you wanted to make things difficult for yourself, you could almost carry it out to absurdity if you had a one month short plan year. You could take the amount and calculate the amount that's due for the short plan year, which is, of course, pro-rata charges and credits. Divide that into four pieces and pay it weekly. Or the IRS has been advising people that it's not unreasonable to calculate the amount that you would owe if you had the full plan year. Take 25% of that, pay it in your case on the first quarterly date. Now you have the end of your short plan year that you said was approximately a quarter of a plan year.

MR. HARTMANN: No, I said four months because I wanted to make it that it wasn't an even quarter.

MS. MARTICELLO: Oh, okay it wasn't. Okay.

MR. HARTMANN: It wasn't an even amount of quarters.

MS. MARTICELLO: Okay, that's fine. We can do that, too. You pay the first quarterly. Then you have a little leftover amount because you're making it to the first quarterly in your plan year and you're not making it to the next date. And that amount would be due after the end of the grace period following your short plan year. That seems a reasonable way to do things.

MR. HARTMANN: So you mean a second quarterly payment maybe like a 1/12 payment?

MS. MARTICELLO: Well, it wouldn't be a quarterly payment, really. It would be a settle-up payment that would be due at the end of the grace period following the short plan year, eight-and-one-half months after the end of the short plan year. Let me just say, you said one thing that confused me a little bit. You said if you had a short plan year because the plan terminated. If you look at revenue ruling 79-237, you don't have a short plan year in the year your plan terminates. You have a full plan year. Your charges and credits to your funding standard account are prorated in a certain way, and your interest is charged and credited in a certain way. But you don't officially have a short plan year in that case. So you still have your four quarterly dates in the plan, for the plan year during which the plan terminates. If you have a bona fide short plan year then.

MR. HARTMANN: But does your method work?

MS. MARTICELLO: No. If you have a terminating plan, then what you would want to do is calculate what you owe that year, your required annual payment for that year.

MR. HARTMANN: The full annual rate, right?

MS. MARTICELLO: Well, no. The real, the true required payment for that year. And then you would just apply the lesser of the 90% or 100%. Of course, in this case the lesser amount is going to be for the year in which the plan terminates. Calculate your quarterlies, you still have the same quarterly dates. You still have the same plan year and you would just go ahead.

MR. HARTMANN: So that's different in the terminating plan than it was for the change in plan year.

MS. MARTICELLO: Right. Because you don't have a short plan year in the case of a terminating plan. You have a short plan, but no short plan year.

MR. HARTMANN: Well, the charges are prorated because of terminating. That's why I think of it that way.

MR. RICK A. ROEDER: Is there any exception to what seems to be the general IRS posture of refusing to admit to the validity of partial or total benefit plan waivers? This came up in view of something that was in the periodicals in March 1992.

MS. MARTICELLO: Well, the IRS never refuses to admit to the validity of anything that's valid. I don't know how you could say that.

MR. ROEDER: Well, let's say PBGC views it with different validity than the IRS does in this case.

MS. MARTICELLO: There's been a lot of confusion on the IRS position. The IRS decision is that in order to achieve a standard plan termination you can have what's called euphemistically a different allocation of assets than a 4044 allocation of assets in which majority owners, people who own at least 50%, forgo an allocation of assets until everybody else has their benefit assets allocated to their benefits. This is in order to achieve a standard termination. However, no individual in a qualified plan can waive his or her benefits. It's not a permitted forfeiture under Section 411. It's 401(a)(13). It could be an alienation or assignment. There's a million reasons why you can't do it. PBGC I think is working on some regulations that on its part might help to clarify this also. It can be done in a terminating plan to get a standard termination. It's just not called a waiver.

MR. ROEDER: Okay, I have a follow up question. Does the IRS differentiate between someone who has waived 100% of his or her benefit versus someone who had waived participation in the plan?

MS. MARTICELLO: I do not agree that anybody can waive his or her benefit.

MR. ROEDER: Okay. But does the IRS acknowledge that you can elect out of the plan and waive participation?

MS. MARTICELLO: I think that there was something. In one of the old regulations there was something about being able to elect out of participating in the plan for a year. For any specific year. Oh, are you talking about somebody who elects not to participate in the plan period, ever? Or somebody who just elects not to participate during one year?

MR. ROEDER: No, in the plan ever.

MS. MARTICELLO: No problem. They're out.

MS. JUANITA I. FERNANDEZ: This is a question regarding quarterlies. Suppose that your final contribution for the prior plan year is not made until seven months after that plan year. So you don't have a bona fide credit balance to apply to the first two quarterlies for your year, but you do have a credit balance after that. Can you apply your credit balance to the next two quarterlies, and if so, from what date is interest on the credit balance calculated?

MS. MARTICELLO: The interest on the credit balance will be calculated from the last day of the prior plan year in each case. Now, let me explain. I mean you should not use the credit balance to debit against your quarterly requirements if the contributions haven't been made. I mean what's the worst thing that can happen to you if you do this? You've made incorrect calculations of your quarterlies. You have a penalty that applies if the contributions are not made. So you have to bear in mind that failure to make the appropriate quarterly is something the results of which you don't know until the end of the year, and they take the form in a charge in the Schedule B. I mean it's not a disqualifying event or anything like that.

MS. FERNANDEZ: Right. But this would be a situation where you would know that you don't have to make the last two quarterlies once the final contribution for the prior year is made.

MS. MARTICELLO: You can do that.

FROM THE FLOOR: Could you clarify what you said about the interest if that contribution was made on June 30 following the end of the year? Would it get interest?

MS. MARTICELLO: If the contribution is made on June 30, following the end of the year, it's within the period under 412. I always get 404 and 412 mixed up. I think 404 is (a)(6) and 412 is (c)(10), but I get them mixed up. If you make it within eight and half months after the end of the plan year, you're within the grace period. It's as if you made the contribution on the last day of the prior plan year. And that means that you get to credit interest on the credit balance as if you had actually made the contribution on the last day of the prior plan year.

MS. PATRICIA J. CONGER: My question has to deal with the full-funding limitation credit for the current liability situation where, on the accrued liability full-funding limit, you're just barely in and the calculation under 412(c)(6) will give you a full-funding limitation credit that causes you to use up your credit balance. Then you go to look at the additional due to the current liability, and I think in reading the Schedule B instructions it looks to me like you just credit an additional credit that is equal to the cash that you would have had to put in in the absence of the current liability. But if you look at the code and regulations you can argue that you put in a big enough full-funding limitation credit to give you back your credit balance.

MS. MARTICELLO: The accrued liability full-funding credit can definitely be calculated to preserve your credit balance, because you subtract your credit balance from your assets when you calculate it.

MS. CONGER: I understand that. But if you're just partially in, your credit balance is going to go away under 412(c)(6).

FROM THE FLOOR: Yes, that's right.

MS. MARTICELLO: Well I guess I would have to see an example. I mean it gets very confusing because you can get to a situation where you have partial application of your accrued liability full funding and your nonaccrued liability full funding or your 412 basis go away, but you still have a base that you have to establish the following year in your Schedule B and amortize over 10 years. So it depends on the magnitude of each one.

MS. CONGER: Okay, I guess it's not clear then whether you can establish it to be big enough to give yourself back the credit balance? I mean I discussed this with people because it can be interpreted either way. Logically to me I say, if they make you take it away for the accrued liability, why would you get it back for the current liability, and they say, well, it reads that way so why not do it?

MS. MARTICELLO: If you want to come up and see me afterwards maybe we can write down some details of your question and I'll take it back with me. I think there isn't really anything clear on that.

MR. KRA: One of the three options under the general old-fashioned 404 max tax was, whatever you have to do to meet minimum funding. In the old days most of the clients put in the minimum funding after the end of the plan year so in that type of situation the Schedule B charges, normal costs and amortization plus interest would be fully deductible. Nowadays clients have to deal with quarterlies, and that generates an interest credit. So the rock bottom absolute minimum you have to put in to avoid a funding deficiency is going to be less than the vanilla end-of-year calculation.

MS. MARTICELLO: Do you mean because of the crediting of interest on the quarterly contributions?

MR. KRA: Correct. Now for the other two parts of max tax, it says calculate it as of the end of the year independent of when you make the contribution.

MS. MARTICELLO: Right. It's interest independent.

MR. KRA: Right. What about where the max tax equals the amount necessary to avoid a funding deficiency? Do I have to actually look at the dates of each contribution, calculate the interest and subtract it in order to know the answer or can I do an end-of-year calculation?

MS. MARTICELLO: Well, I'm going to give you a qualified answer on this. I think that what you can deduct is the amount that you would need to put in to avoid a funding deficiency. And the short answer is I don't think that you need to take into account the interest on the quarterlies. But I'm not absolutely sure of that answer to be honest with you. If you want to give me your name and number, I'll see if I can find out and call you back.

MR. JAMES F. OBERNESSER: What's the IRS's current recommendation, I won't say policy, on the long-standing issue of a plan that's been overfunded and has a negative unfunded both in the prior year and the current year? Should I establish an amortization base, or should I wait until there's a positive unfunded?

MS. MARTICELLO: Oh, you mean the situation under 81-213?

MR. OBERNESSER: That's right.

MS. MARTICELLO: The equation is a requirement in the regulations. It says unless the commissioner provides otherwise. Now, in situations where your plan is fully funded for more than one year, we used to tell people that, if you set expected unfunded equal to minus your credit balance, and your actual unfunded is always going to be zero in that situation, because it's the excess if any. Then the amount of the base that you have to set up would be perfect because you would automatically be subtracting your credit balance. What it boils down to is in years when you're in full funding before you actually have an experienced loss where you have some sort of nonnegative unfunded where you have to set up a base, you could technically set up a base each year equal to your credit balance. And then you're going to work out. But I mean why go through the exercise?

MR. OBERNESSER: Well I raise the issue I think because, consider the numbers. I mean probably five times out of 100 it will make a difference in terms of effecting your full-funding credit, and you can construct an example where it will effect your credit balance in terms of how much credit balance you might erode in any year. So that it does present a practical problem in that you don't come to the same answer in all cases.

MS. MARTICELLO: You mean, if you set up the credit base in one year, then you have an amortization credit for which the base disappears the next year because you're in full funding.

MR. OBERNESSER: That's right. The base disappears. So the base isn't the issue but if I set up for example a gain or loss base, it will give me a smaller or larger full-funding credit or in some cases, I may not get a full-funding credit because I have set up this base. So I can look at the situation two ways. One way I get a full-funding credit, another way I don't. I may or may not reduce my credit balance. So that it does present differences in results in some cases.

MS. MARTICELLO: I can see where it would, but again I'm afraid I can't give you any specific guidance. This issue has been kicking around since 81-213 has been kicking around, and there hasn't been a satisfactory answer to it yet.