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NOT GONE BUT FORGOTTEN

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The panelists will review various provisions of the laws and regulations of the IRS, Department of Labor (DOL), and PBGC that are in effect but often overlooked by practitioners.

MR. DONALD J. SEGAL: I'm with the Segal Company. Joining me on the panel are Abbey Keppler who's an associate with the law firm of Stroock & Stroock & Lavan, and Susan Smith who is Vice President in the Detroit office of Towers Perrin.

We're going to go over a potpourri of items in ERISA, the code, the various regulations. These are all in existence, and they are items of which a lot of us might not be aware -- they're not too high in our consciousness -- and probably are not being obeyed in a significant number of plans. Adrian LaBombarde in the session on Late-Breaking Developments was talking about compliance and maintaining the proper effort at compliance and being able to show that you're making efforts at complying with the law, good faith compliance. A lot of these items have to do with compliance. Abbey will lead it off, talking about some of the penalties that are around, and then Susan and I are going to engage in a dialogue on some of the more interesting aspects that we actuaries always love to talk about.

MS. ABBEY L. KEPPLER: When Don asked me to join a panel in Las Vegas entitled "Not Gone But Forgotten," the first thing that came to my mind was ERISA penalties. Until recently, ERISA penalties did not really pose much of a threat. As a result, they were largely ignored by plan administrators and employers, probably because they were also ignored by the Department of Labor and the PBGC. Some of the reasons for the difference in attitude with respect to IRS penalties (which everyone focuses on) and ERISA penalties can be seen by comparing how the penalty sections are drafted and how they're imposed. IRS penalties, often called additions to tax and excise taxes, are specific, automatic and, like all taxes, self-assessing. By comparison, the sections of ERISA that provide the penalties generally are (1) not specific as to the violations for which they can be imposed, (2) limited to court awards as a result of successful litigation, and (3) with only one exception are completely discretionary.

Compare, for example, Section 4971 of the code. It provides for each taxable year an employer who maintains a plan to which Section 412 applies, there is hereby imposed a tax of 10% on the amount of the accumulated funding deficiency under the plan determined as of the end of the plan year ending with or within such taxable year. In a similar fashion, Section 4972 of the code states in the case of any qualified employer plan, there is hereby imposed a tax equal to 10% of the nondeductible contributions under the plan determined as of the end of the taxable year of the employer. Well, the code is rarely cited as a model of clarity which I think Don

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just pointed out. These sections are fairly unambiguous. It's pretty clear that if a minimum funding deficiency exists as of the end of the plan year or nondeductible employer contributions remain in the plan at the end of the correction period, the employer is subject to a specific penalty, 10% of the amount of the accumulated funding deficiency or nondeductible contributions, whichever applies. The employer also is required to assess the tax himself by filing Form 5330.

On the other hand, there's ERISA, Section 501: "Any person who willfully violates any provision of Part 1 of this subtitle or any regulation or order issued under any such provision shall, upon conviction, be fined not more than $5,000 or imprisoned not more than one year or both." Look at Section 502(c)(1) which provides, in part, that "any administrator who fails or refuses to comply with a request for information which such administrator is required by this title to furnish to a participant or beneficiary, unless due to reasons beyond his control, by mailing the material within 30 days after such request may, in the court's discretion, be personally liable to such participant or beneficiary in an amount of up to $100 a day from the date of such failure or refusal." It's pretty broad in application as compared to the code. But perhaps the biggest reason that ERISA penalties have been ignored is that prior to 1988, with only one exception, they could only be assessed for violations that resulted in successful court actions. Up until that time the only penalty under ERISA that could be assessed by the Secretary of Labor without litigation was for prohibited transactions.

Section 502(c)(2) of ERISA which allows the Secretary of Labor to assess a penalty against a plan administrator for failure to file an annual report and Section 4071 of ERISA which allows the PBGC to assess a penalty against any person who fails to provide any required notice to the PBGC were added in 1987, and made effective in 1988. So, prior to 1988, ERISA penalties generally were limited to discretionary court awards, and, as is generally the case, the courts took full advantage of the broad discretion that was left to them. You're probably most familiar with the maximum penalty of $100 which may be imposed against a plan administrator for delay or failure to provide requested information because notice of that penalty is usually and required to be included in a summary plan description. It's usually under a heading called "Your Rights Under the Law." Although there's probably been few actions filed for delay or failure to provide information alone, it's often an additional count when a participant or a beneficiary files an action for wrongful denial of benefits or breach of fiduciary liability.

As a result, there are reported decisions that address the failure and address the imposition of this penalty. A review of the cases reveals that the courts have really handled the matters very differently. Some courts have taken a no-harm/no-foul approach, and if the participant who requested the information was not harmed or prejudiced by the failure to provide it timely, there was no penalty imposed. Other courts recognize that the penalty was designed to induce compliance with information requests, and in those cases they did impose a penalty without a showing of either bad faith or prejudice to the requesting party. But even when the penalties were imposed by the courts, they ranged from $5 a day to $100 a day. Notably, in one case, which was later reversed for other reasons, $78,000 was awarded to the participant for a failure to provide plan documents and a summary plan description.

Although no changes in law have occurred, ERISA penalties have recently become a somewhat hot topic, at least with respect to the penalties that can be assessed directly by the Department of Labor and the PBGC pursuant to Sections 502(c)(2) and 4071. Even though both of these sections were effective for 1988, they have not really been enforced to any great extent. However, recently both the Department of Labor and the PBGC have announced that they would pursue increased enforcement.

As I mentioned earlier, under Section 502(c)(2), the Secretary of Labor may assess a penalty against any plan administrator of up to $1,000 a day from the date of such administrator's failure or refusal to file an annual report, and for this purpose, an annual report will be rejected and treated as not filed if it has a material deficiency. Up until now, in applying 502(c)(2), the Department of Labor has focused on annual reports were filed with serious deficiencies.

In 1990, 60% of all Forms 5500 were submitted with material deficiencies. At that time, the procedure was to send a series of three letters, and the penalty was not imposed unless the deficiency was not corrected. By June 1991, it was reported that total assessments under Section 502(c)(2) equaled only $4 million. Now, $4 million may sound like a lot of money, but considering the number of pension plans and welfare plans that are required to file annual reports, it's really not very much. Recently, the Department of Labor announced an expanded civil penalty program with respect to Section 502(c)(2). According to the press release, the Pension and Welfare Benefits Administration now intends to identify and penalize late filers and those who fail to file. Enforcement efforts will go back to 1988, the first reporting year for which the penalty was applicable. Since the three-year statute of limitations does not begin to run until the annual report is filed, plan administrators who fail to file reports will continue to be exposed to the potential penalty indefinitely. Under the program, the plan administrators who voluntarily file annual reports after the due date, with extensions, for 1988 and subsequent years, will be considered late filers who may be assessed a $50-per-day/per-plan penalty, for the period in which they failed to file, and plan administrators who fail to file completely may be assessed a $300-per-day/per-plan penalty, which can accrue up to $30,000 a year. As part of the program, the Pension and Welfare Benefits Administration is providing a one-time-only, golden opportunity to file overdue annual reports without incurring the full penalty. This grace period will run until September 30, 1992, and plan administrators who voluntarily file for 1988 and subsequent reporting periods during the grace period will be assessed only $50-per-day. That's not so important, but what is important is that the maximum penalty per plan will be only $1,000. So, anybody who hasn't filed should do so. Filings after the expiration of the grace period will be subject to larger penalties.

On March 3, the PBGC issued a policy statement to advise the public of the manner in which it intends to exercise its authority under Section 4071 of ERISA. Apparently, the PBGC finally woke up and realized what this provision could mean to them. Up until now it had never imposed the Section 4071 penalty. Under the statute, the PBGC may assess a $1,000-a-day penalty for the failure to provide a variety of notices that are required to be made to the PBGC, including PBGC Form 200, which is the notice that the aggregate amount of missed required payments exceeds

$1 million. Other required notices include PBGC Forms 500 and 501 with respect to standard terminations, Forms 600 and 601 with respect to distress terminations and post-distribution certifications. This penalty also applies to notices of reportable events and notices of withdrawal from multiemployer plans. By the way, in addition to assessing penalties, the PBGC could void a termination if the termination notices are not filed timely which would send the employer all the way back to square one as far as terminating the plan.

MS. SUSAN M. SMITH: And that's happened.

MS. KEPPLER: In its statement, the PBGC indicated that several factors would be considered relevant in determining the amount of the penalty it would impose, such as the extent of the failure, the financial or administrative harm to the PBGC as a result of the failure, the willfulness of the failure, and my personal favorite, the likelihood that the penalty would be paid. In applying this penalty to the failure to notify the PBGC of a reportable event, the PBGC will consider whether any notice was submitted within the 30-day period for which you're supposed to notify them of a reportable event, and, if so, exactly what information was missing from the filing. In this regard there's a footnote in the policy statement that says, in most cases, the penalty for failing to provide notice of a reportable event would be limited to $10,000.

Also in this statement, the PBGC indicated that failure to provide a post-distribution certification in a standard termination should not exceed the lesser of $50-a-day or $200 times the number of participants entitled to termination distributions. The PBGC also said it will institute administrative review procedures under which someone who has had a penalty imposed can come forward and present facts and circumstances to support a reduction of the penalty. Although the PBGC announced that it will not currently apply this penalty to PBGC premiums, it's still considering policy issues in this area.

That's the background on ERISA penalties, but I'd like to point out exactly what these penalties could mean, so, I will go over a few examples. To emphasize the point, I'm going to ignore those limitations that the PBGC and Department of Labor said that they would apply and work with the statutory penalties for the most part because (1) they're not bound by those statements, and (2) who knows, they could have a change of heart, as the IRS did with respect to reasonable actuarial assumptions for funding purposes. For purposes of the illustration, we're going to use maximum penalties. For example, assume an annual report for 1991 is never prepared, and suppose on November 1, 1992, 50 participants request copies of the annual report, and if they request it, they're entitled to receive it. Naturally, it's not provided because it doesn't exist at this point in time. Under these circumstances the 502(c)(2), $1,000-a-day penalty could be imposed against the plan administrator starting on July 16. In addition, if each of the 50 participants is successful in a court action, the plan administrator could be held liable to them collectively for another $5,000-a-day starting on December 1. By January 1, 1992, the plan administrator, which is often the employer, could be facing a liability of over $300,000 simply because he failed to comply with ERISA's requirements with respect to annual reporting. However, if the Department of Labor limits the annual penalty to $30,000, total exposure will be limited to a mere $185,000.

An even more amazing result is reached if the PBGC imposes Section 4071 penalties to the full extent permitted by the statute. Suppose a financially-troubled company simply stops funding its underfunded defined-benefit (DB) plan and fails to provide any notice to the PBGC or participants. This will trigger a variety of IRS and ERISA penalties. If we look at the period from January 1, 1992, through January 1, 1993, and assume that quarterly contributions for 1991 were $150,000, a remaining contribution of $500,000 is required on September 15 for the 1991 plan year, and quarterly contributions for 1992 are calculated to be $200,000. On January 15, you miss the $150,000 quarterly contribution. It's a reportable event, but no report is made to the PBGC. Thus, you've got $1,000-a-day penalty beginning to accrue on February 15. In addition, the employer doesn't provide the participants with notice of the missed contribution as he's required to do under Section 101(d) of ERISA within 60 days after the contribution is missed. If participants are successful in actions filed with respect to this failure, a court could award up to $100-a-day to each participant for each day the failure continues, starting with the last day of the 60-day period, and that's the penalty under Section 502(c)(3) of ERISA.

Going forward, a quarterly contribution of $200,000 is missed on April 15, once again a missed reportable event, and a separate $1,000-a-day penalty can begin to accrue on May 16, and, again, there's potential liability to participants if you don't notify them. On July 15, the $200,000 quarterly installment is missed, and again no notice is given. So, starting on August 15, another $1,000-a-day penalty begins to accrue. On September 15, the $500,000 payment is missed, and no report is filed. This event will trigger two additional reportable events, an IRS excise tax and, again, potential liability to participants for the failure to notify them of the missed contribution. This is first reportable as a missed contribution, just like the missed quarterly contributions were, and then it's a separate reportable event, because at this time, the aggregate of missed contributions to an underfunded plan exceeds $1 million, and that's a separate reportable event. In addition, there's now an accumulated funding deficiency of $500,000 subject to the 10% excise tax under Section 4971 of the code.

MS. SMITH: It's actually more than that because you missed January 15 also. Right?

MS. KEPPLER: Yes. So, now you've got $200,000-a-day for reportable events starting September 15, the excise tax which you're reporting on September 15, and finally an October 15 quarterly installment. That's missed without providing any notice to the PBGC and without providing notice to participants.

Don, you're an actuary, so give me a hand. What's the maximum penalty that could have accrued for the reportable events under Section 4071?

MR. SEGAL: Approximately $873,000.

MS. KEPPLER: Very good. What's the maximum aggregate amount of the 501(c)(3) penalty which could be imposed if 10 participants file successful court actions for each time that they were supposed to be notified of a missed contribution and weren't?

MR. SEGAL: Something in the neighborhood of $649,000.

MS. KEPPLER: And now the revised amount for the Section 4971 excise tax. That's easy.

MR. SEGAL: That's a mere $65,000.

MS. KEPPLER: So, a grand total of?

MR. SEGAL: $1,587,000 for one year.

MS. KEPPLER: One year.

MS. SMITH: Plus they still owe the contribution.

MS. KEPPLER: Right. So, even if the PBGC limits each reportable event penalty to $10,000, you're still going to have $60,000 for potential liabilities just for the missed reportable events. I recognize that these examples are extreme and that probably failures with respect to this would not continue because somebody's going to notify this employer that he's got to start reporting, and I think that the chances are probably less than one in a million that cumulative maximum penalties would continue to be assessed during the period. However, in light of the recent announcements by the Department of Labor and the PBGC, no one should continue to ignore ERISA penalties. Enforcement efforts have clearly been stepped up. The risks have increased, and the stakes have risen in this area.

MR. SEGAL: By the way, before we go on, the one thing I forgot to mention is that what you hear are the opinions of the panel. They do not represent the beliefs held by our employers, the Society of Actuaries, our legal counsel, or possibly even us.

Let's first discuss top heavy plans. When I talk about a buy-in, I mean if your plan is top heavy, (remember, these rules have been around since 1984) I'm referring to the requirement to provide a minimum benefit if it's a defined-benefit plan or a minimum allocation if it's a defined-contribution plan. If you are operating with the combined limits under Section 415(e), if you're top heavy but not super top heavy, your fraction, where you had a 1.25 multiplier in either the defined-benefit limit or the maximum allocation automatically goes down to a 1.0, but you can buy into that 1.25 if you either give an additional 1% benefit accrual for the 10 years or an additional 1% contribution allocation. Now I want to ask the question what happens when you don't buy in? What happens if you decide after 1984 or after your plan first became top heavy to buy into the 1.25? We have had absolutely no guidance on this in over eight years. You might say in a DB plan it should be relatively simple because you could always retroactively credit people with the increased top heavy benefit, but on a defined-contribution (DC) plan, I don't understand how you can go back because you run into all sorts of problems including possibly running into the 415(c) limit if that's considered an annual addition in a year where you're making an effort to buy in.

MS. SMITH: What I think is important here, Don, is that if you don't do the top heavy testing, you don't know whether you've got a problem. It crops up later in an audit, that's the problem, or if you have a problem in other areas, you'll be asked the question or the plan sponsor will be asked the question has this plan been administered in compliance with ERISA? The auditor will start asking, "Where's your top heavy testing? Where are your 415 limit tests on people who have received distributions?" And if you can't produce all of this information, that's when the going gets rough, and then you've got the question of retroactivity.

MR. SEGAL: That's right. Then what happens if a plan goes from top heavy to not top heavy. That's wonderful. It opens up your fractions. If it goes from not top heavy to top heavy, you could have some cutbacks in people's benefit anticipation. You're protected under 411 so there can't be any cutbacks in the accrued benefit, but it can be a severe cutback in the anticipated benefit.

MS. SMITH: Next is our favorite subject, 415 limits and the phase-in. I'm not sure we all know all of the rules about it, but we do need to keep in mind that with tax reform, what used to be something that accrued over service now is accruing over participation, and this means if you put a brand new plan in, and cover individuals, they must accrue the rights to the maximum dollar limit over future years of participation. It used to be you could put the plan in, and someone who had 10 years of service automatically was up to the current dollar limit and 100% of the compensation limits. This is no longer true. One good thing is that if you have any portion of a fractional year, you can give someone the full 10%. So, there is a minimum accrual rate of 10% of the total limit in one year or any fraction of a year, including a day.

One of the things that is not well-defined yet is, what constitutes a benefit change? What are those things? The IRS has gone on record as saying it is anything that increases the accrued benefit immediately or gives rise to an accrual that is higher than what it otherwise would have been prospectively. It does seem, based on the Blue Book, that there were certain areas that Congress thought should be exempt from these phase-in regulations. We've not seen anything definitive from the IRS, but you need to keep your eyes out for it because it's our understanding that there is something that's being drafted. Our hope is that it would give some kind of exemption to career pay plans with past service updates to increases for retirees.

Maybe it will clarify what has the most murkiest of waters in this area -- open windows, the special early retirement provisions where additional benefits are given to individuals who would elect to retire during a specified period. You have to be very careful because what looks like a large dollar limit, or even 100% of pay at normal retirement age, becomes considerably smaller at these early retirement ages of 55 and 50 which is generally the group that's has incentive to retire. There is a cost-of-living adjustment (COLA) on the compensation limits that we may forget about. To the extent someone leaves at 45, was relatively highly paid, had accrued a high benefit that might have exceeded 100% of that person's then-compensation, as long as that benefit doesn't begin until some later date, keep in mind that you can inflate the 100% of his then-compensation up until the time that benefit distributions begin. The plan doesn't have to have any special wording to do this. Similarly, for someone who retires where the 100%-of-pay limit applies to him, increases in his 415 limit can occur as long as the plan provides for it.

MR. SEGAL: The important thing there is that this indexation starts at the date of termination. There is a little glitch in the regulations. They say you're to look at the defined-benefit limits to get a calculation of the indexation, but ever since they started freezing and reducing the DB limits that doesn't help us. You sort of go back to the basics of how the indexation has been calculated.

MS. SMITH: What would have happened had they not reset?

MR. SEGAL: But it's absolutely clear in the amendments that froze or reduced the dollar limits that they had no intention of changing this indexation of the 100% of the highest three.

MS. SMITH: Furthermore, 415 limits, it must be remembered, apply only to the employer-provided portion of the benefit. Again, looking at an example of an individual who terminates under a contributory plan at age 45, there must be careful communication to the individual what his accrued benefit will be, and you will not want to tell him or her what is the employee-provided or the employer-provided portion at that time because that's not determinable as long as they don't withdraw their employee contributions until a later date, namely, when benefits begin. In the meantime, those contributions in the plan must be continuing to receive credit at the stipulated rate of interest. So, that's one way to phase out of the 415 limit problems as far as I'm concerned because those rates of interest are much, much higher than you'd be using to get present values of employee and employer-provided portions of benefits. Furthermore, with tax reform -- all employee contributions to both defined-contribution as well as defined-benefit plans are now taken into consideration to determine the annual addition -- it used to be that you only looked at after-tax contributions in excess of 6% of pay and all pretax contributions. Now it's every dollar.

MR. SEGAL: The next item is early retirement windows. What we have to worry about there in terms of the little details is nondiscrimination. Remember, based upon the final 401(a)4 regulations, current availability tests must be met for the early retirement windows. Fortunately, this applies to those who are eligible, not those who take it. We also have to be mindful of integration, that when you are accelerating the payment of the benefit, if you're giving him or her five years service plus five years of age, and then paying the benefit with or without another kick in the early retirement factors, you may very well violate the integration regulations, and this is similar to the case where if you give a postretirement COLA on a plan that's integrated to the limit, technically you're violating the integration regulations. The government services tend not to take a very careful look at this, but we don't know what the approach is going to be with respect to these early retirement windows because there's a real potential for a violation of the integration regulations. Be sure you don't violate the Age Discrimination in Employment Act (ADEA) of 1967 regulations. For example, you can't give them five years of service and five years of age to everyone except those beyond age 65. That's age discrimination because the older you are, the less you're getting.

MS. SMITH: Suspension of benefits is the next topic. These rules have been in effect since 1982 plan years, generally. How many of your clients are following the notice requirements. Generally, anyone who is rehired after having previously retired

on an early or a normal retirement date or anyone who continues to work beyond the normal retirement date must be given a notice. It's supposed to be either by personal delivery or first-class mail, and it's supposed to be made during the first calendar month or the first payroll period in which those benefits payments would not have been made or otherwise are withheld, and this notice has a lot of requirements that have to be in it in terms of why this suspension was occurring? What kinds of things are in the plan and what sections in the language? So, there is a notice requirement in order to permit the suspension to actually take place under the rules, and plan provisions must clearly have these kinds of requirements spelled out in them. Payments are generally made when people do retire the second time.

They must resume on the first day of the third calendar month after the calendar month in which the participant ceases what is called substantive employment. The magic number to remember here is generally people who do not work more than 40 hours within a month. There's something else that you can use if you have a five-week pay period or so on, they generally are not considered to be in substantive employment. So, companies have to pay very particular attention to part-time employees where the hours tend to fluctuate, and these people can be coming in and out of substantive employment. If you're trying to suspend benefits, good luck. You want to kind of manage it so that they're either always over or always under so that you've got them on one side of the fence, and they're not crisscrossing back and forth.

You must be careful of the Omnibus Budget Reconciliation Act (OBRA) 86, and the ADEA rules in designing benefits that are suspended. You also must pay particular attention to the mandatory distribution rules which we'll talk more about in a moment because you're kind of sitting here betwixt and between, and you have a lot of different things all operating on individuals who generally are tending to work beyond the normal retirement age. Don's going to talk a little bit about the fact that these provisions apply only to the employer-provided portion of the benefit. Remember, we've talked just a minute ago about the fact that that's not really determined until the benefits begin to be paid. I don't know what happens to somebody who's had their benefits suspended and which piece of it you're supposed to be paying attention to because it's not really determined.

MR. SEGAL: First of all, if you do not have proper suspension of benefits which meet all of the requirements set out in the regulation, it means you must either pay that benefit or give him an actuarial increase. Now, the suspension of benefits quite clearly applies only to the employer-provided benefits. So, if you have a contributory plan where you have what you consider to be proper suspension of benefits, it gets to be a real mess if someone works past age 65. I have this little problem here. It's a contributory plan with simple benefits – $30-per-year of service. So, this person has 20 years of service at age 65 or a $600 benefit. The benefits are properly suspended. If he or she works one more year (and let's assume the actuarial increase to age 66 is 112%, 1%-a-month), at age 65, the accrued benefit derived from employee contributions (ABDEC) was $200 which means you had a $400 employer-provided benefit which you could suspend, and you had a $200 employee-provided benefit which you could not suspend.

Now, as a combination of both additional contributions and actuarial increase, the accrued benefit derived from employee contributions at age 66 is now $235. The total benefit at age 66 is now $630 which gives you a net employer-provided benefit of $395. Have I violated the vesting rules of 411, the anti-cutback provisions? The rules talk only about the total accrued benefit. My total accrued benefit went up, but, quite clearly, my employer-provided piece went down. Does anyone have any ideas as to what the right answer is? Can I pay this person $630 or do I have to pay at least $635? What happens is that I'm almost deeming the entire increase due to employee contributions. Needless to say, we have no guidance about this one, but be careful, this one is deadly.

MS. SMITH: Is this a definitely determinable benefit?

MR. SEGAL: It's definitely determinable. We just don't know how to calculate it.

MS. SMITH: Mandatory distributions. When must distributions under qualified plans begin to be paid? This probably applies to nonqualified plans, but we know those people will always make sure they get what's coming to them. Individuals who are 70.5 in 1992, by the way, would be exempt from this as long as they weren't 5% owners. So, if you find any of those individuals on your valuation files, they're okay. Otherwise, payments must begin by April 1 of the calendar year following the calendar year in which the participant became age 70.5. It's interesting to note this is totally unrelated to the plan year that you're working with or the valuation date or anything like that. It has to do solely with calendar years.

So, how can we help our clients administer this? One of the things we've tried to do is change our standard age and service distributions which always used to come up with a group of employees who were 64 and over. I asked people to create another bucket; namely, let's go 65 through 69, and then let's create 69 and over which is essentially 70 and over, and if anyone pops out during the valuation process in that particular 70-and-over category, and we notify the company that they're still being paid. We ask the company if it has started benefit payments to these individuals? Once we've isolated any of these individuals, we try to bring them over and treat them as retirees in a special category so that each year we can monitor whether they have been given a benefit increase or not. They should have one if they've continued to work based on the accrual for the most recent year.

How are these continuing accruals supposed to be calculated? Technically, one could argue that every day someone works they've got a little bit more service, and maybe they've got a little bit higher final average pay if it's a pay-related plan, so you should turn out a new benefit calculation, right? Maybe you could do it monthly because you're only paying benefits monthly. What I've recommended to clients is that they try to look to the April 1 date by which these increased payments must begin and work backwards from that on an administrative basis to identify, in the first quarter of a calendar year, who attained age 70.5 and who was over 70.5 and receiving benefits. Calculate the increase for those who were already receiving payments. Send them a notice, and start the higher benefit payment on April 1. Just state that this is your procedure. One gets messed up in terms of do I have a suspension of benefits to the extent that the person accrued a half-a-year of service nine months ago, and I'm only paying him now? I don't know the answer to that, but, again,

you've got to have some mechanism that's practical and doable in order to effect these changes. I don't think that has been questioned. It may not have to even be in the plan, but I think there still should be some kind of an administrative procedure.

An area to watch out for in communicating with the individual is getting election forms at the time the benefits commence. What is your payment form? What alternatives are you going to offer to an individual? If they retire with $500 at age 70.5 or start getting their payments on the April 1 following, and they want to elect, say, a joint-and-survivor (J&S) option, what happens when you tell them next year there's another $30?

MS. SMITH: If the payment was on a 10 years certain-and-life, what is paid in the second year? Is it nine years based on the $30 or is it another piece of a 10-year period marching from that point forward?

MR. SEGAL: I suggest that the proper answer to that one is what does your plan say?

MS. SMITH: That's right, it needs to be clearly spelled out.

MR. SEGAL: The best solution is 10 years from 70.5. So, it's nine years, eight years, etc.

MR. SEGAL: That's right, and then you have to actuarially reduce it or is that a revised normal form?

MS. SMITH: Are these definitely determinable benefits? There's also a question to the extent that there are employee contributions. When a payment is started at age 70.5, and there are additional payments that might begin thereafter, how do these rules work with regard to the fact that at some points in time you can look to the first distributions as being return of tax-free employee contributions? Other times you're required to look at them as a pro rata share, and so I think that kind of ruling needs to be looked at. The individual needs to be given some counselling, not tax advice, to determine which camp he's in.

MR. SEGAL: Next, let's talk about spousal waivers for lump sum payouts before reaching early retirement age. Many of us have plans that provide for lump sum payouts in the case of termination prior to early retirement age. We all know the rules for the $3,500 cashouts. Basically, you can do an involuntary cashout if the present value of the benefit is less than $3,500, but more and more plans are now having lump sum cashouts above that level, very often to avoid paying future PBGC premiums on these vested terminated people who are never going to come out.

But they're well-funded plans. How many people are aware of that? Under the final Retirement Equity Act (REA) regulations, the plan must offer the option of an immediate annuity before you can cash them out. There is no such thing as spousal waiver of a deferred spousal right. They can only waive their immediate right to a joint-and-survivor annuity. They can't waive the right to collect a joint and survivor annuity 10 years from now. So, that's why you must offer them an immediate annuity. And

the last item is that you should be specific in your plan regarding what basis is it going to be calculated on? Don't default. Be specific in there.

MS. SMITH: Qualified joint and survivor. Most valuable benefits. What is the normal form? Well, that's certainly something that needs to be defined in the plan very carefully. Once you have that definition, there needs to be some care in designing the factors that are used to convert payments under the normal form to payments under an option form. If, for example, you've defined the normal form as being a life annuity for those who were single, and you've defined the qualified J&S annuity as being the normal form for those who were married, you must thereafter use the qualified joint and survivor form as it applies to an individual to determine actuarial equivalencies under all optional forms. If you've stated in your plan that the normal form is defined as a life annuity for everyone, but in the case of someone who is married who will be presumed to have automatically elected the qualified joint and survivor optional payment form, you've avoided that additional complication, and all conversions can be made from the life annuity form.

There is, however, one other wrinkle. To the extent that you subsidize optional payment forms, there needs to be a check to be sure that the qualified joint and survivor optional payment form subsidies are the largest of any, and the case where you're most likely to run into problems is where you have lump sum payments because those are likely to be the most heavily subsidized of anything. We're not sure of all of the answers to some of those questions.

MR. SEGAL: One of the cute wrinkles that the regulations and the law throw at us, for example, is if you're lump summing somebody out, you may not deem yourself to have a subsidy, but there's the minimum interest requirement of Section 417(e).

MS. SMITH: The applicable interest rate comes into play, and at that point I'm not sure whether that affects it or not because I certainly can't squirrel around with all my optional payment forms as that rate goes up and down. I would tend to say forget that one.

MR. SEGAL: Section 401(a)(4) testing. We could spend the next couple of weeks on this one, but I'll refer to part of the general test. By the way, a little plug here. One of the sessions we're going to have at next Spring's pension meeting is "Who's Afraid of the General Test?"

If you have a DB plan that has what was called a uniform formula in the proposed regulations -- they express the same thought in about 20 words now -- you are permitted to test only on the most valuable benefit. By the way, in my comments here I'm presuming that you have a familiarity with general testing and the restructuring of the plan into what I'll call cells. If you have a situation where one of the cells happens to require satisfaction of the average benefits percentage test in order to pass, where we can use basically the percentage, which is the average between the safe harbor and the nonsafe harbor percentage, it says in the regulations that you must do that test on the normal benefit percentage. This is now requiring you to do two calculations where they just told you you could do one. The reference, by the way, is 1.410(b)-5(d)(7).

Briefly summarized, it says that if you have a subsidized joint and survivor benefit or subsidized early retirement benefit, then you'll have to test using the most valuable benefit, but there is an exception in the very next paragraph which says that if the ratio of the nonhighly compensated getting that subsidy to the highly compensated is at least 70%, then testing on most valuable doesn't apply, and this is a mandatory exception. It's not a voluntary exception. So, now they've given you this wonderful waiver, sort of, so you only have to test the most valuable benefit, and then you have to do your second calculation to do the average benefit percentage test. It's totally inconsistent. Hopefully, they'll change it when they change the regulations because, to me, there's no logical basis for it.

Then we have the accrued benefit derived from employee contributions, the ABDECs. We all know that the regulations say that you must prove nondiscrimination separately for the employee-provided and the employer-provided benefit. However, the regulations say that you have three possible ways of satisfying the test for the employee-provided benefit, the uniform rate, the total benefits, or the grandfather rules. There are no other options. We do not have a general test that is applicable to the employee-provided benefit. You must use one of the three, specified tests.

I mentioned ABDECs. Let's talk a little bit about how you calculate an ABDEC. This is one of my favorite topics. When are we going to get guidance on how to calculate the ABDECs? Since 1988 you've been accumulating your mandatory employee contributions, to borrow a term from the code, at 120% of the federal mid-term rate, to the date of determination (we don't know what that is yet). You then project it forward at the plan 417(e) rate which is defined as the lesser of the plan actuarial equivalent rate or 100% or 120% of the PBGC interest rate. (I would recommend at this point not to bother with the 120%, it gets too complex.) Then you convert it at the 417(e) rate which again is 100% or 120% of the PBGC rate but not greater than the plan rate.

Then as you read on in the guidance we have, which is Revenue Procedure 89-60, it talks about the minimum return. Your minimum return with respect to the employee contribution is the present value of the ABDEC. The way you get it, if you trace back through the reference they give you, which is Revenue Ruling 78-202, is take the benefit that you've calculated payable at age 65 as an annual benefit, reconvert it into a lump sum using the immediate 417(e) rate at which you converted, and then discount it back to the determination date at the same rate which is what I'll call the deferred 417(e) rate. So, you have sort of an accumulated employee contributions with the specific interest rate. You run it forward to retirement age, convert it, and then to determine the present value of that you convert it back into a lump sum and discount it back. So, fortunately, you're following the same path going forward and back which is very nice.

However, they also go on to say in 89-60 that there's another test you have to do and that the present value of the total accrued benefit cannot be less than the present value of the employee contributions you're giving back. You test with interest and mortality. So, if you're in a position where, let's say, you had a $200-a-month benefit payable at 65, and the employee-provided benefit was $180, you'll very often wind up in the position that if you return the employee contributions at the required interest rate, the present value of the $200 is less than what employee contributions

accumulated. So, by giving back the contributions, you've satisfied the total benefit, including the employer benefit. Basically, you've wiped out the employer liability. It's very nice. That's exactly what the regulation says.

MS. SMITH: And you don't have to pay PBGC premiums.

MR. SEGAL: That's right.

MS. SMITH: We're going to talk about the 3% accrual rule. This rule is the one that states that the benefit that is accrued in any one year must be at least 3% of the projected total benefit accrued at the normal retirement date, and lots of times I think you tend to think of this in an individual situation. The point that we wanted to make was that the projected benefit is supposed to be the projected benefit that could be earned by the participant who began participating at the earliest possible age in the plan. In other words, if you have a 21-and-1, you've got to use 21-and-1 all the way to your normal retirement age of, say, 65, and then measure the accrual in each one of those years to make sure that it is 3%. So sometimes people look at a person who's 45 and look at the span of time from 45 till 65, and that's not cricket.

MR. SEGAL: Next, is Internal Revenue Code Section 6050(i). What is it? It's a money laundering regulation.

Notice 90-61 concerns reporting by employee plans and exempt organizations of certain amounts of cash received in a trade or business under Internal Revenue code Section 6050(i). Section 6050(i) of the code provides that any person who is engaged in a trade or a business, and in the course of such trade or business receives cash in excess of $10,000 in one transaction, shall file a return with respect to such transaction as prescribed by the Secretary. Now, here's where it gets to us. Section 7701(a)(1) of the code defines "person" to include an individual, a trust, an estate, a partnership, an association, a company, or a corporation. Organizations exempt from the federal income tax under Section 501(a), including employee plans (emphasis added) are persons as defined in Section 7701(a) and are subject to the requirement to report cash transaction in the same manner and to the same extent as any other entity treated as a person under the Internal Revenue Code. Failure to file such returns are subject to penalties. What this seems to say is if a qualified plan either receives or possibly disburses more than $10,000, such a transaction must be reported under this section of the code.

Notice 90-61 was intended to give us guidance. It seemed to say, yes, it covers you. I will say there is a question here. Going back to what we talked about before in terms of penalties, Adrian LaBombarde, in another session, talked about one of these areas of compliance that you don't want to trip over. I really don't have an answer as to how it applies, but it's one of these other little bits of trivia that we have to worry about. This is a clearly "not gone," but not many people are remembering this one.

MS. SMITH: Are wire transfers cash? I think so.

MR. SEGAL: Yes, cash transactions.

MS. SMITH: Yeah, cash transactions, but we're worrying about contributions the employer sends to the trust, if they're both considered people, and about payments that are made in excess of $10,000.

MR. SEGAL: Let's briefly talk annuity starting date. Just to remind you, there's a 90-day notice in terms of an annuity starting date, plus certain extensions, if you don't provide them with enough information. The important thing is technically there is no such thing as a retroactive annuity starting date. Here again, we're talking administration. How many plans have it where the paperwork just isn't done by the person's actual date of retirement or the commencement of benefit date? How many other times does someone come into the personnel office on Friday and say, "I'm quitting today?" "By the way, I'm retiring effective Monday. Send me my check." There's no such thing as a retroactive annuity starting date. So, in case an optional form is elected, either the joint and survivor is waived or there's an optional form. You really have to pay on the normal form or the automatic form until the 90 days are up and then you go into the elected form. I think this is an area that they may pick on once they start the more extensive examinations of plan administration. So, again this is just a reminder.

MS. SMITH: Actuarial gains and losses. What if a plan's actuarial accrued liability is less than the actual value of its assets? In other words, we have a plan that's in surplus, and it's in surplus at both the beginning of the year and the end of the year. We need to remember that somewhere along the line in there the IRS has decided that you can never have an unfunded liability that is any smaller than zero. In other words, it may not go negative. We're all used to saying a plan in surplus has a negative unfunded liability, but when you're trying to calculate gains and losses the expected unfunded liability and the actual is zero. Therefore, there has been no gain or loss for the funding standard account, and that's what you need to report on the Schedule B.

Now, keep in mind that for purposes of testing reasonable actuarial assumptions these give you some rather interesting results. In other words, they could mask some relatively high gains. When I asked Jim Holland about that at one point in time his comment was, "Well, just send us an addendum and show us what the real gains and losses are." I said, "No way. I'm giving you exactly what you asked for, and if it's zero, it's zero." So, it just says that on audit you're not ratting on yourself as you file your Schedule B.

Now, what if the plan's actuarial accrued liability was less than the actuarial value at the beginning of the year, but at the end of the year the plan had popped out of surplus and is now sitting there with a positive unfunded liability? Do we have a gain or a loss, and, if so, what is it? Well, it is equal to the unfunded actuarial liability. It is not equal to what you would have gotten had you calculated expected versus actual using negatives. So, for example, if you really had a loss of $10,000, and now you found yourself unfunded by $6,000, your loss for that year is $6,000, not $10,000. The question then becomes one of, gee, is this one of those I amortize over five years? Well, I'm not sure. As far as I'm concerned, Revenue Ruling 81-213 still sits out there. I don't think anyone's put anything in writing that I'm aware of that has countered that, and that particular revenue ruling stated that the unfunded liability in this particular situation is amortized over 15 years.

MR. SEGAL: This also comes to the question, in case you had a credit balance, what do you set up as your base to put yourself back into balance? You could wind up with a huge gain or a huge loss that you're amortizing. Probably a huge loss in that case.

MS. SMITH: Due dates. Form 5500 filling, including the Schedule B. What is the general rule for when you're supposed to file?

Seven months after . . .

MR. SEGAL: After the end of the plan year.

MS. SMITH: What happens if my plan year begins January 2? When is it due?

FROM THE FLOOR: August 31.

MR. SEGAL: August 31, not August 2.

MS. SMITH: If your plan year ends December 31, it's due July 31. So, if you want to have a little fun, you can give yourself a one-month extension by changing your plan year to the second day.

MR. SEGAL: The exact wording is, "the end of the seventh month following the close of the plan year." It doesn't say seven months following the close of the plan year.

MS. SMITH: Right. Now, short plan years. There has been some question in the past as to what are the filing dates when you have a short plan year. It was clear that when the short plan year went from some time to the last day of a plan year, what would the last day have been? You always measured it from that last day of the short plan year. We had a problem if the company changed the plan year. Let's say they went from a plan year that began October 1 to a calendar year plan year. With respect to the short plan year that began on what was the first day of their old tracking plan years but ended only three months later, when was the Form 5500 and the Schedule B due? We used to argue that you'd count off from the first day of that ongoing plan year which would mean you stayed on the same cycle in that situation. In the 1990 Schedule B instructions there's wording that clearly states that you must now mark that due date from the last day of the short plan year in that situation, which is a change to some of us.

Furthermore, there are a couple of little wrinkles where it's not quite the same. If you have a plan termination, you must continue to file Form 5500s. It's questionable as to what the Schedule B says after a certain point in time, but the Form 5500s must continue to be filed as long as and for any plan year in which there is $1 of assets sitting in the qualified plan trust. However, for the year in which there is a plan termination, and if it's in the middle of the year, it says in the instructions that you may not use a short plan year rule; you can use the last day of that plan year as the time from which to measure your filing deadline. If you make your final distribution and it's in the middle of a plan year, your filing requirements for that time go back to the short plan year rule, and that date of final distribution is treated as the end of the

short plan year. So, the thing to remember is your general short plan year rules, and then just remember that plan terminations go to the end of the plan year. If you have a final distribution, then go back to your short plan year rules. Real simple.

MR. SEGAL: And just a reminder -- after the plan year in which the plan terminates, there is no requirement for a Schedule B. There's a Revenue Ruling that says that.

FROM THE FLOOR: When your plan is terminated, the last Schedule B you have to file is for the plan year in which the plan terminated. Even though you may still file Form 5500s because you haven't distributed your assets, there's no requirement for a Schedule B. You don't even have to give them a blank Schedule B?

MS. SMITH: Yeah, but if they didn't check the box, the IRS would send it back to the client and say incomplete. So, we used to start putting in a Schedule B that said: Note. This Schedule B has no information on it because the plan was terminated in such-and-such a year. Then the box checker would say, "Yep, has a Schedule B," and by the time somebody read it, they'd understand there was nothing in it.

MR. SEGAL: The question on the 5500s says is this plan subject to the minimum funding requirements? The answer, after you've terminated, is no.

MS. SMITH: Final plan year minimum contribution. We're still operating under the two-and-a-half months plus an automatic six-month extension after the close of the plan year for which the contribution is being made. So, keep in mind that while there are quarterly contributions, that last payment for a calendar year plan needn't be made until September 15, and that's an automatic. It doesn't matter whether plan years are coincident with fiscal years or anything, and that was another thing I wanted to mention on the Form 5500 filing. If you had a plan in a fiscal year that is coincident, that seven months' deadline is automatically extended to September 15 as long as the employer has received an extension for filing the tax return until that date. I saw a situation where an employer filed early in the year for the extension to September and then filed their return in April, but that didn't change the filing date. It's still September 15. So, they essentially filed for a refund, used the refund to make their final minimum contribution and Schedule B filing.

MR. SEGAL: Do quarterly contribution requirements stop when the plan terminates?

MS. SMITH: We're not sure just when they stop.

MR. SEGAL: What about a calendar year plan termination date of September 30? Do I not have to worry about my October 15 quarterly? I don't know the answer to that one.

MS. SMITH: We don't know. PBGC Form 1, including Schedule A, seem to be fairly cut and dried. Eight-and-a-half months after the first day of the plan year. There are special rules, however. When you have a brand new plan you can have a plan that's adopted relatively late in a year, and you can still be doing calculations and design into the next calendar year, and there are rules that will permit you to make filings later than when you otherwise would have had to.

PBGC Form 500 and 501, as Abbey mentioned, are the filings with the PBGC for standard plan terminations. They require an actuary's certificate in most situations. Keep in mind the Form 500 must be filed 90 days after the date of the plan termination but not before you have sent the required accrued benefit notices to participants. Sometimes that is where we get a little messed up, and there is a possibility, I believe, that that 90 days may be extended. Ron Gebhardtsbauer is nodding yes. Ron is with the PBGC, by the way. Form 501 must be filed within 30 days after the final distributions have been made to the participants, and that's one that's commonly overlooked. Everyone's so glad to be through the hoop that they kind of forget to make that last filing. That can cause problems.

MR. SEGAL: Because we're talking about due dates, let's talk about the Saturday, Sunday and holiday rule. This was raised at one of the meetings at the session on the Schedule B. What are the rules for Saturdays, Sundays and holidays, postmarks, etc.? This is Internal Revenue Code (IRC) Section 7502 and 7503. Section 7502 deals with timely mailing treated as timely filing and paying. Section 7503 is time for performance of acts where the last day falls on Saturday, Sunday or a legal holiday. Now, Section 7502 says that for the purposes of deadlines, the postmark with the U.S. Postal Service controls in determining whether a deadline has been met. I emphasize U.S. Postal Service. Federal Express is not the U.S. Postal Service.

MS. SMITH: Nor are postage meters.

MR. SEGAL: Right, nor are postage meters. It's postmark. For example, let's say it's October 15. You're extended. Form 5500 is due. Don't send it Federal Express. Send it U.S. Mail. Federal Express doesn't count.

MS. SMITH: You also want to send it return receipt requested. I had a client who did so and saved himself because the IRS lost his form. It sent out a notice stating that it did not have his 1954 or whatever, it was 1964 forms on file. "Please send them to us, and, by the way, you're late." He almost got disqualified. Well, someone rummaged through the back room and found the return receipt request that had been mailed and found copies of the forms that had been mailed. That particular company sponsored four plans, and, believe it or not, the IRS was then questioning whether all four plans were in that one envelope? Well, luckily they were only auditing one, and someone said, "If I'm going to send this once, I'm going to put all four of them in there." That's something I'd never thought about cautioning a client on. Somehow with return receipt requested there's no proof of how many plans were contained in the envelope that you sent. A return receipt request only says a piece has been received by the IRS when it comes back.

I think there were signed copies. The actuary had dated it. The date of the actuary's signature was just before the mail date, and so it made sense that it all had happened.

MR. SEGAL: Section 7503 deals with the weekend and holiday rule where it states that if the due date falls on a weekend or a holiday, then the due date is the next working day. However, if you do a careful reading of the code and the final and proposed regulations under 7502, it appears that neither of these sections applies to minimum funding and quarterly contributions, these provisions seem to apply only to

due dates for filing of returns and for payment of taxes. The proposed regulations, in addition, say that payments to a bank, trust, etc., if postmarked two or more days prior to the due date are considered to be received on time even if delivered after the due date. Otherwise, payments, including wire transfers, must be received by the due date. This is in the proposed regulations under Section 7502. Now, the language of the code and regulations in 7503 make it seem pretty clear that the weekend and holiday rules do not apply to minimum funding payments and quarterly contribution deadlines, but they do apply for the Form 5500 deadlines. One thing, let's give credit to the PBGC. They make it absolutely clear when they put in their due dates that the Saturday/Sunday/holiday rule applies. I couldn't find it in the instructions to the 5500.

MS. SMITH: It doesn't apply to the contribution, though.

MR. SEGAL: But it doesn't apply to contributions; these are not considered payment of taxes. Also, even if these sections did provide relief to the due dates for contributions, in any event, they would not apply to Title I because the due dates for minimum funding payments and quarterly contributions are contained in both Title I and Title II of ERISA. Therefore, even if you did have relief under Section 7502 and 7503 with respect to the code requirements, a payment after the fifteenth of the month would still be a violation of Title I of ERISA. Of course, no one knows what the penalties are under Title I of ERISA.

MS. SMITH: In short, advise your client to make quarterly contributions on the Friday before. That's the safe way.

MR. SEGAL: Right. The so-called 412(c)(8) amendments. Just a few reminders. A 412(c)(8) amendment is an amendment that is adopted within two-and-a-half months after the close of the plan year and is intended to apply retroactively to the entire previous plan year. The two-and-a-half-months is two years for multiemployer plans, but there are three conditions: (1) the date of adoption, (2) it must not reduce accrued benefits determined as of the beginning of the plan year, and (3) it must not reduce accrued benefits as of the time of adoption of the amendment, or, if it does, the plan administrator has to file a notice with the Secretary of Labor, who either approves it or does not act within 90 days which is a deemed approval.

MS. SMITH: What are we trying to approve? Why do we care about this? What is this letting us do?

MR. SEGAL: If you adopt what I will call a retroactive amendment, the most important thing is you must attach a statement to your Schedule B saying you've adopted the amendment, stating the date of adoption. You've got to say it doesn't reduce accrued benefits determined at the beginning of the year.

MS. SMITH: But that's only if you wanted to reflect it in the funding standard account for the preceding plan year. That's it, right?

MR. SEGAL: Yes, if you want to reflect it in the funding standard account for the preceding plan year. That's why you have it.

MS. SMITH: If you don't care, then don't pay any attention to it.

MR. SEGAL: But people adopt these amendments. They forget to do the attachment to the B, and, technically, failure to do the attachment to the B invalidates the amendment.

MS. SMITH: But that's only in the case that they wanted to reflect it in the preceding plan year in their funding standard account. Is that not correct?

MR. SEGAL: That is correct.

MS. SMITH: Okay.

MR. SEGAL: But in the days of compliance amendments, it might happen again.

MS. SMITH: Nobody wants to accelerate cash contributions, right?

MR. SEGAL: I just wanted to comment on a proposed regulation, 1.412(c)(9). It's very interesting. There's a proposed regulation that seems to say you can do your valuation within one month prior to the beginning of the plan year with respect to that plan year. No one knows much about that one. And then the last thing we want to talk about is the mid-year plan changes. Revenue Ruling 77-2. The shall, shall nots and may nots.

MS. SMITH: What must be true to reflect a plan change in the funding standard account for a plan year? Well, it must have been adopted and/or effective within that plan year. I think the most common errors occur in negotiated plans. I'd just like to walk you through this.

We've got a calendar year plan year. We have a basic benefit level of $10. There's a negotiation, and it's going up $1 in the first year on April 4, 1992, $2 a year later, and $3 the following year. We have choices here in terms of how you can reflect it. You can use the general rule. The general rule says that you reflect an amendment for the portion of the year in which it is in effect. That doesn't say adopted. It says in effect. In that situation, the general rule would have picked up in the first year, $1 for three-fourths of the year. Now, the second year you would have to pick up the rest of the first dollar, and then for three-fourths of the $2 increment. In 1994 you'd pick up the rest of the $2 increment from 1993 and three-fourths of the $3 increment. The last piece comes in 1995 for the rest of the $3 increment from 1994. Now, if you were following Revenue Ruling 77-2, it says that you can make a choice any year. You're not making an actuarial method change. You're not locked into it with respect to any other amendment. If an amendment is adopted after the valuation date within that year, you can choose to ignore it until the following year.

Compared to the general rule, we could pick up nothing in year one, 1992, but in year two we'd pick up the first dollar in full, and then we're subjected to the pro rata shares of the next two bumps in the contract. Does anybody know why we don't have an alternative in the second and third year to not reflect those next bumps? The amendment was already adopted in a previous plan year. You have no choice when it becomes effective.

MR. SEGAL: This is one of the shalls.

MS. SMITH: You shall reflect it on a pro rata basis in the second year, and you shall reflect the $3 on a pro rata basis in the third year. Now, there is an actuarial method that can be selected and followed consistently by the enrolled actuary. It has the same rules in terms of changing methods. In that case you say, "Well, what if I don't want to do these intermediate bumps? I want to go directly to the ultimate benefit level in the current contract as each contract is negotiated." In that case, in year one, 1992, if you're following the general rule, you have a choice of the $6 increment on a pro rata basis for three-fourths of a year, picking up the remaining portion of that $6 bump in year two. On the other hand, Revenue Ruling 77-2 still controls here because, remember, it was adopted and effective in 1992. So, you have to choose whether you want to defer any recognition to the following year (the second year), in which case you'd pick up the full bump of $6 that second year.

There are a lot of people who are having problems with this, and you need to watch for regulations also from the IRS as to how you determine what is a proportionate allocation of these benefit increments? We always used to kind of look at these increases and look at the portion of the liability including some normal costs. Now we're seeing the IRS kind of espouse a split. If you've got a dollar bump that occurs three-fourths of the way through the year, you get 25 cents in the first year and 75 cents the next year, and you use that for your funding standard account, your current liability, and full funding limits. And that's different than what we've done in the past.

MR. SEGAL: Just to pick up on what's been mentioned before, there is some varying opinion as to how you calculate full funding limitation and things like this.

MS. SMITH: Well, we think that'll be cleared up with these new regulations, and we may not like it.

MR. SEGAL: There's varying opinion within and without the Service on this one. I have one last note. The $3,500 cashout rule applies to the total present value of an accrued benefit when you have a contributory plan. If, for example, you return the employee contributions, and this gives the employer-provided benefit a value of less than $3,500, you cannot involuntarily cash them out if the original amount was over $3,500.