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CONVERSATIONS WITH YOUR UNCLE

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This session will give IRS representatives an opportunity to address specific issues of their choice. Adequate time will be allotted for interaction with the audience as well as time for questions and answers.

MR. STEVEN D. BRYSON: I'm very pleased to have Kathy Marticello with the Internal Revenue Service and Harlan Weller with the Department of the Treasury. Both Kathy and Harlan have some opening remarks they wish to make. We will try to allow as much time as possible for questions and feedback.

MR. HARLAN M. WELLER: The views you're going to hear are my personal views and do not reflect the opinion of the Department of Treasury, or the Service, or the administration at large. We've been much more aware of making that disclaimer every time we speak, ever since the tax court took quite an important note on what Ira Cohen said in a 1984 speech in the actuarial assumptions cases. So we don't want this to eventually show up in a tax report transcript ten years into the future, so that's the caveat.

Before we get to the questions and answers, I will bring you up to date on a little of the legislative activity that actuaries might be interested in that's going on in Washington. There's actually quite a lot going on. It's a very active period for Congress, and I will touch on five different topics. The first topic is PBGC issues. As you probably know, the administration introduced the Retirement Protection Act of 1993 to Congress last fall. And in April there was a hearing at the House Ways and Means Committee. Yesterday there was a hearing of the Senate Finance Committee to discuss the provisions of the Retirement Protection Act of 1993. The act covers a lot of territory. And, depending on the number of questions we have later on, I can get into more detail about the provisions that are in the act. I hope, actually, to get a chance to get feedback on whether some of the proposed changes seem to work from the perspective of actuaries in the field.

I certainly know that, for instance, last year when I went to the San Diego pension and health issues meeting, someone buttonholed me in the corridor and said that the then existing pension PBGC bill—which was HR 298 that Representative J.J. Pickle (D-TX) had introduced—doesn't work with the funding standard account. He explained to me why it doesn't work, and I appreciated that. And I think when the administration crafted its bill, we fixed the problem this particular actuary had pointed out in terms of not properly keeping track of a credit balance in the funding standard account. The Pickle bill actually doesn't permit you to have on ongoing credit balance in this certain context.

I'd like to specifically defer on the issue of cross testing. That is one piece of legislation that is going slowly through the Congress. We actually expect that there will be a markup of the bill, which is the very first step in the committee action sometime

fairly soon. All four committees that have any interest at all in PBGC issues—which are the two tax writing committees and the two labor committees—are also interested in helping.

As you might be aware, circulating throughout Congress are many versions of health bills, so there's a lot of committee staff and committee member emphasis on health right now. It's going to be a little hard to get their attention for PBGC provisions. In fact, we got some attention yesterday. I think we have some momentum going that the PBGC bill will start moving through the legislative process.

Already halfway through the legislative process are the pension simplification provisions. These have been bouncing around for a few years. They were included in the two tax bills that were passed by Congress in 1992 and vetoed by President Bush. There's not much change in the provisions from all of those past years, but I think they may be subject to some reexamination in the Senate. The House, once again, took the existing package and just passed on through.

One of the provisions I found most interesting, and I don't think it has received that much attention but I think it probably deserves more attention is one in the bill that modifies the full-funding limit. As almost everyone knows and probably hates, there is a full-funding limit that is based on 150% of current liability in addition to the full-funding limit based on the plan's accrued liability. And there is a provision in the bill that would permit certain employers—and it's defined in terms of employers whose liabilities in their plans are predominantly active—to apply the full-funding limit without respect for the 150% of current liability requirement. And the bill then goes on to say that the Department of Treasury is supposed to figure out how much this is going to increase deductions on the part of those employers and make a compensating adjustment in the 150% that applies to the rest of the world. It's a fairly arcane, complicated provision and the Department of Treasury hasn't taken a position on it. But I'm surprised that more employers haven't said that this is stupid, or get rid of it. But at this point, it is in the House bill.

Probably the most controversial portion of the House bill is the 401(k) safe harbors. There is a plan design that if you promise a particular matching contribution, then you'll be deemed to pass the 401(k) average deferral percentage (ADP) test without actually running it, so it's a plan-design safe harbor. The fact is that it is only a matching requirement. There's an alternative in which you can have a flat contribution, I think it's 3%, or there's a matching pattern that you can offer. And if you do either of those, you don't have to run the ADP test. Some people don't believe this is appropriate, and I think that in the Senate you might see some change in that safe-harbor provision.

In particular, people have noted that there is interaction between the cost of the safe-harbor provision and the reduction in the plan compensation limit of $250,000. Because of the lower plan compensation and the fact that they may be taken into account under the ADP test, as we discussed in the prior session, some 401(k) plans are having a harder time passing the ADP test. Deeming them to pass the ADP test under the safe-harbor plan design is giving away more essentially, which makes it a more expensive provision, which then raises some issues as to whether it's an

appropriate provision to have in the bill. So I think a long hard look will be taken at the 401(k) safe harbor again.

Other things are going to probably fly on through. I don't know anyone who likes the family aggregation rules. They clearly are there to protect from that particular abuse. But I think most people have concluded that they are more trouble than they are worth. This bill has moved through the House. The administration has not taken a position on any of the particular issues, so I can't say whether we support any of them. We may get involved if the Senate has different provisions; we'll lodge our recommendations at that time. But right now this Congress is acting without our particular input.

The third set of issues that are getting play in Congress are Social Security issues. Three different things belong to Social Security, one of which is not particularly meaningful, at least from my perspective. It's almost an inside-the-beltway kind of issue. It is whether Social Security is going to be an independent agency. Right now it's actually part of Department of Health and Human Services (HHS). People think that if it was made independent it might have a little more visibility, a little more independence, and maybe a little more efficiency. I'm not sure, but I don't think that's a very significant provision.

There is also what is known informally as a nanny tax bill. Those of you who have ever looked in the 3000s of the Internal Revenue Code (IRC) can find this. There are some very interesting provisions as to who is responsible for paying Social Security taxes in terms of whether you're an employee or an independent contractor. And there are many exceptions. It's also very difficult to find some of these exceptions because some are found in the definition of who's an employee, and other parts of the exceptions are found in the definition of what are wages. And you have to look in all possible places to find exceptions to who's subject to Federal Insurance Contributions Act (FICA) tax. You can find some interesting things there.

Here is one of my favorite ones. If any of you happen to have the Communist party as a client, remember that any employee of the Communist party does not pay FICA taxes. Don't ask me why, but Congress passed that law 40 years ago. I guess that's so they can't collect Social Security benefits later on. So there are many exceptions.

One is that if you have a domestic employee—and that means someone who works in your home—and that domestic employee earns less than $50 in a year, then he or she doesn't pay FICA taxes. If the person makes more than $50 in a year, you as the employer are supposed to pay FICA taxes.

As a father of now a one-year-old, I know that babysitters cost quite a bit; $50 doesn't go very far. Fifty dollars was established in 1951 and has never been changed since that time. So there are several proposals to increase that $50 threshold, primarily to get the casual babysitter, lawn-mower-type person out of the Social Security loop. At the same time, it has also raised the visibility of the issue so the hope is that the full-time nanny will get back into the loop. People have sort of blasted the whole provision. They have said it's all so ridiculous, they won't pay taxes on anybody at all. Maybe making it a more realistic provision in terms of the

dollar threshold as well as simplifying the forms procedures will result in more people complying with the law. I can testify that in my state I had to fill out 11 forms last year on behalf of my domestic employee. There's hope to cut that down to two or three forms, making it easier to do and making a more realistic threshold. The major point of difference now between the Senate and the House versions of the bill is what the appropriate threshold is. I believe the House bill used $1,250 a year and the Senate used $630 a year, or vice versa, I've forgotten right now. But in conference they're going to resolve that difference.

Both bills also included minor shifting between the disability insurance (DI) fund and the old-age and survivors insurance (OASI) fund. It looks like—if I have the direction right—the DI fund is getting a little bit low so they want to shift some from the old-age security fund to the disability fund for a few years to try to shore up the disability fund. In the long term on Social Security, ex-chairman Dan Rostenkowski (D–IL) of the Ways and Means Committee has introduced a bill to help shore up Social Security in the long term. And I think that he was very much trying to get ahead of the curve by suggesting some fairly minor tinkering with the provisions now to help solve the long term financing issue. Those of you who pay attention can see that the trustees' reports from the last two or three years on the Social Security system showed deteriorating financial conditions in terms of the year running out of money moving forward from 2050 to 2030; I think it is now at 2028 or something. So given the direction of the trend, something should be done. And Mr. Rostenkowski has proposed some fairly minor modifications having to do with the benefit formula and, again, the retirement age, which he believes will be enough to solve the problem and reverse the trend. Again, I have a copy of the bill, and if we have more time, I can discuss some of the issues.

I'll quickly mention health care. Health care is all consuming for everyone in Congress right now. For those people who are paying close attention to it, actually five full committees are involved in preparing health care bills, and another half dozen committees have interest in pieces of the bill. For instance, the Veterans Committee has an interest in the veterans' portion of the issues. And the Indian Committee has an interest in the Indian issues. But both tax-writing committees, both labor committees, and on the House side, Representative John D. Dingell's (D–MI) Energy and Commerce Committee, all five committees will be writing full versions of a bill and it all has to be worked out.

At this point, the House Labor Committee has nearly completed its work in terms of issuing a bill, and the Senate Labor Committee has also completed its work and has issued a proposal. Neither of the tax-writing committees have gotten that far. In fact, the Senate Finance Committee members indicated to the President a couple of days ago that they believe they're deadlocked; they hadn't figured out how to handle the issue of an employer mandate yet. And the Ways and Means Committee is working to try to come up with something that they can agree to, or at least 20 of the 38 members can agree to, so that they can send something to the House floor.

The last thing I want to talk about in terms of the legislation picture is Title I issues and in particular the fall-out from the Mertens decision. Those of you who have been paying attention know that I believe it was last year, the Supreme Court ruled that in the case of *Mertens* vs. *Hewitt Associates*, the only recompense that Mertens could

ask against a nonfiduciary was what was called equitable relief. It's not a dollar relief but it's what a court of equity can do, which includes things like injunctions but not actually forcing, through the court, money to be paid to Mr. Mertens. In doing so, they also sort of said, "By the way, we're not even sure that you could have any kind of liability by nonfiduciaries under Title I of ERISA."

As they were writing everything else they noted that whether we can have any liability for nonfiduciaries is an interesting issue. Several courts have taken up that opinion and have said, "Yes, we think there really is a problem here." They've thrown out many cases against nonfiduciaries who participated in fiduciary breaches. And the Department of Labor is working to restore what it views as the pre-Mertens law. It thinks that the idea that a nonfiduciary can act with impunity and not worry about getting sued, and even if the person does get sued not be subject to any kind of money damages, is obviously a poor incentive system when we have a program in ERISA that is intended to protect workers. So nothing has come out yet. But I think we're going to see much interest in this issue of fiduciary and/or nonfiduciary liability as well.

There's some interaction with the health care issues in terms of whether you set up procedures for denial of claims. In the Health Security Act that President Clinton proposed last year there were some new rules in terms of how beneficiaries interacted with health plans and what kind of remedies people have if they are denied their claims. And I think this is all going to be tied in to one big issue about administrative procedures and employer/employee litigations. So a lot is going on. And depending on the amount of questions, I can fill in some of the details on any of these pieces of legislation.

MS. KATHRYN G. MARTICELLO: I also would like to repeat the caveat that any opinions I express are strictly my own and don't represent the official position of the Service. And then I'd like to talk just a little bit about some of the broad principles underlying some remedial amendment period issues that we've seen.

When we talk about remedial amendment period issues, we're talking specifically about disqualifying provisions. And more specifically, the disqualifying provisions we're all interested in right now are the ones that are listed in Section 1.401(b)-1(b)(2)(ii) of the regulations. And those are the provisions relating to or the lack of provisions that cause a plan to fail the requirements under Tax Reform Act of 1986 (TRA 86), the Omnibus Budget Reconciliation Act of 1986 (OBRA 86), and OBRA 87. Now we're also talking about disqualifying provisions under 1.401(b)-1(b)(2)(iii)—I always feel so bureaucratic when I quote these big long numbers of the regulations—that say that the commissioner can designate certain provisions as disqualifying provisions subject to the remedial amendment period and has so designated changes under Technical and Miscellaneous Revenue Act of 1988 (TAMRA 88).

Now for the purposes of TAMRA 88, OBRA 89, OBRA 93 and Unemployment Compensation Amendments of 1992 (UCA), the remedial amendment period has been extended to the last day of the 1994 plan year, but there has been a little bit of confusion as to exactly how this works. I'd like to just briefly go through some of the issues that can arise. And I'm going to start with form defects in an

existing plan. Now an existing plan is a plan that was adopted before January 1, 1988, for these purposes. Suppose you have a disqualifying defect in such a plan, but this defect is totally unrelated to any of the laundry lists of rules and regulations that I have just gone through. For example, maybe the top-heavy provisions in your plan are wrong, or you have consent provisions under your joint and survivorship (J&S) that are wrong, or you don't have definitely determinable benefits. Now that would not fall under the extension of the remedial amendment period; it is a disqualifying defect, but you would not have until the end of the 1994 plan year to correct such a defect. Depending on when a defect arose—there is some program relief under our Revenue Ruling 82-66. That revenue ruling gives you blanket relief for a disqualifying defect if you request a determination letter; you have qualification relief for the year in which you request a determination letter for a prior year. So you can go back one year and your plan will be treated as qualified for that year. But you would have to correct all the way back to the effective date of the offending provision to requalify your plan.

You wouldn't be able to take advantage of voluntary compliance resolution (VCR) for that kind of a defect. It would be a form defect but you might be able to take advantage of the walk-in closing agreement program (CAP). Now suppose you have a plan whose form does not satisfy the Tax Reform rules that were effective before 1989; for example, the 415 rules that were changed under TRA 86 or the interest rate changes that were made for lump-sum distributions. Those provisions are only blanketed under disqualifying defects for purposes of being eligible for the extension of the remedial amendment period if you satisfy all the rules under Section 1140 of the Tax Reform Act. So you need to have operated your plan in compliance, for example, with the new 415 rules from the date that they were effective, the first limitation year beginning in 1987. Otherwise, you would not be eligible for remedial amendment relief for those provisions.

Now your plan form is going to be different from your plan operation, and it has to be different from your plan operation because you're supposed to operate in accordance with the requirement, not in accordance with the terms of your plan. However, that's OK. You're not providing benefits that are not definitely determinable. You do have the remedial amendment period in which to go back and amend your plan. But you're supposed to amend it so that your amendment is consistent with the way that you operated.

Suppose your plan form does not satisfy the requirements of the Tax Reform Act of 1986; that was effective subsequent to 1988, effective in 1989. Then you do have until the end of the remedial amendment period to amend retroactively. You have to amend retroactively all the way back to the effective date of those provisions. In essence, you are amending both the form of your plan and the operation of your plan. In general, you would not be able to amend backwards in a way that takes away any benefits from anyone. In other words, you have to take care of Section 411(d)(6) concerns.

MR. WELLER: With the exception of 401(a)(17).

MS. MARTICELLO: There are certain exceptions, right. Well, 401(a)(17) is one exception. And there are other certain limited exceptions in the model amendments

under Notice 88-131, etc. where for some highly compensated individuals there is some permission to reduce benefits below what Section 411(d)(6) would otherwise allow. But these defects in your plan form can be fixed retroactively.

Now suppose you have an existing plan and you make an amendment to that plan after December 31, 1987. If that amendment introduces a disqualifying defect into your plan, then you have until the end of the remedial amendment period to correct that disqualifying defect. Now, of course, that doesn't mean that, if you amend your plan after 1987 and don't introduce a disqualifying defect in it but you happen to have had a disqualifying defect in your plan, relating to top heavy for example, the mere amendment of your plan doesn't mean that you can fix your top heavy defect during the remedial amendment period. If you have a new plan, that's a plan that you adopt after December 31, 1987, then everything is fair game under that plan. You have until the end of the remedial amendment period to fix any disqualifying form provisions in that new plan.

If you have an existing plan and you have operational defects totally unrelated to the Tax Reform Act of 1986—for example, you didn't allocate employer contributions in accordance with the terms of your plan—you don't get remedial amendment period relief for that; that's an operational defect. You didn't operate in accordance with your plan terms. It's not a TRA 86 problem, so the only thing that you can do, because it's an operational defect and the form of your plan is OK, is go into the VCR program to try and correct the defect.

Operational defects that arise because plan terms do not reflect TRA 86 required changes effective in 1989 and after (those are going with the changes that I discussed under form defect), when you fix your plan for your TRA 86 form problems, of course you will have to bring it up to snuff retroactively, and that sort of includes operational corrections. Because if you change your benefit formula retroactively, of course, you will be giving people the benefit of that formula.

There may be problems under the discrimination rules—operational defects that may arise not as a result of any defect in your plan. For example, you could have a plan that in form may or may not satisfy the discrimination rules, based on your demographics. So your plan form could be OK, but, for example, you might fail coverage in one year because of the new 401(a)(4) requirements, or you might have a plan formula that passes the general test in one year but doesn't pass the general test in another year. You would have up until the end of the remedial amendment period to cure those defects. But after the end of the remedial amendment period, you will still have a certain retroactive period under the regulations; under (a)(26) and under (a)(4), I think it's −11 and (a)(4), you still have a certain retroactivity to correct your discrimination problems.

And, of course, the standard of correction is a little bit different prospectively. Say you want to correct to a reasonable good faith compliance standard from the period stretching from the effective date of the rule to the effective date of the new regulation. For that period you can't bring your plan up to that standard retroactively. Generally the good faith standard will be based on prior positions of the Service, unless they were changed by the statute; however, you may not be able to get a determination letter that would give you reliance all the way back for bringing your

plan up to a good faith position. If you don't want to extend your actual TRA 86 nondiscrimination amendment all the way back, an amendment that fully complies with the new regulation, you won't be able to get reliance just for good faith compliance. That would be more or less of an examination issue rather than a determination issue.

MR. S. KRISHNAMURTHY: I have a question about the design-based safe harbor.

MS. MARTICELLO: I think I'll let Harlan answer that one; he's the legal issues expert.

MR. WELLER: The requirement of the design-based safe harbor is that the accrual period match the period the benefits accrue over the same period of time that they do under the formula. So you cannot have benefits reflect all total service and accrue that over a person's participation. Now that's a fundamental rule, but we don't want you to essentially squeeze past service into increasing rates of accrual essentially over years of participation. That means that if you want to reflect past service, you must establish a past-service benefit. Now there is some concern at the same time that there is a test in the regulation dealing with whether the past-service benefit is significantly discriminatory. There's that five-year safe harbor. And they are somewhat independent questions. If you want to be very safe, you could choose to pick up only five years of past service and not even get into the issue of whether you have a discriminatory past-service period under the safe harbor for past service and then use that in your formula and in your accrual pattern under your safe-harbor design. Or, alternatively, you can use whatever demonstrations the Service asked for about prior turnover, et cetera, so that you can prove that it's not significantly discriminatory to take into account the total amount of past service in setting up your initial accrued benefit.

MR. KRISHNAMURTHY: It's still not a general test.

MR. WELLER: It's not a general test.

MR. KRISHNAMURTHY: It's a demonstration and not a discrimination test; is it still a safe harbor?

MR. WELLER: It is a demonstration that the recognition to past service does not create significant discrimination. We recognize that nonhighly compensated people tend to come and go more frequently than managers of an organization. It's certainly not a strict mathematical test, it's sort of a touchy-feely. We try to get away from having touchy-feely subjective tests in these regulations. But this is one in which we thought that we couldn't come up with any kind of numeric test, which is why we have a five-year safe harbor there for people who want to have certainty. But other than that you just have to show that it's not that everyone who was there in the past and who was not highly compensated has disappeared and the only person who could possibly get any benefit out of this for more than five years is the owner. Those are the kinds of facts that we'd be concerned with. If you have one or two people who went beyond five years along with the owner it's probably going to be OK. The test is significant discrimination, which has more margin than a discrimination test.

MR. BRYSON: Can either of you give us a feel for what efforts are going on in the enforcement area with regard to Section 415 in public plans?

MS. MARTICELLO: We have been working to increase the expertise of the field, for example, on 415. And as it relates to public plans, we have been trying to assemble some information at the national office. As I say, we're working on guidelines that will cover Section 415. We have had very many requests for individual letter rulings and requests for general information under Section 415 for governmental plans, which we have answered. So we are trying; however, I cannot honestly say that we have a very large enforcement effort mobilized at this time.

MR. WELLER: I do believe that it was published that a closing agreement was reached with the state of Rhode Island regarding its failure to comply with Section 415. And a closing agreement was reached, but I don't remember the details. I don't know what the plan had to do with the state, but the IRS did catch up with it.

MS. MARTICELLO: We have had other informal inquiries from various entities. And many even have come to the national office to discuss issues with us. But it's all been mostly on an individual basis.

MR. BRYSON: I'm aware that in this state (Texas), there's quite a bit of activity among the sponsors of these plans to get their representatives to work on some legislation that would give certain relief from the 100% of high three average compensation rule for these plans, especially if they're not large amounts of money. Have you gotten any feel for what's going on Capitol Hill?

MR. WELLER: I believe that is in the simplification proposal that I referred to. So it has passed the House as originally proposed.

MR. JOHN M. CRIDER, JR.: Can you give an update on the status of the rejuvenation of Revenue Procedure 85-29 regarding the approval of changes in actuarial funding methods?

MS. MARTICELLO: We have begun, in the actuarial branch at least, to look at those issues, and we hope to discuss it in the near future. We realize that the expiration date for that revenue procedure—he's talking about the automatic revenue procedure for change in funding method—and the time period have expired. We are looking into various possibilities. Possibility number one is extending it. Possibility number two is extending it for a short period of time and then having another layer in which there is an extension for some changes in method, similar to the old methodology in which there were some changes that were specifically spelled out that could be automatic and others that could not. And we're trying to look at what has actually happened during the period when the revenue procedure was in effect to see what problems have arisen because of the automatic changes. And that's been taking us awhile, but we do have some data. And so we have not forgotten about it.

MR. CRIDER: In the meantime, should we fall back on the old revenue procedure?

MR. WELLER: The old 78-37.

MS. MARTICELLO: That's right.

FROM THE FLOOR: In the nondiscrimination regulations there's a section on contributory plans under either passing a demographics test or providing the minimum benefit. A factor from a table is to be multiplied by the employee contribution rate and this amount is to be subtracted from, for example, the base and excess percentage, if it's an excess plan, to determine a uniform employer-provided benefit.

The question I have is this. If doing this process results in an employer-provided benefit in which the accruals are zero, or negative actually, that is, if I subtract the factor times the employee contribution rate from the base I get a negative number, when I subtract it from the excess I get an even larger and absolute value negative number. Is that OK? Is the employer's contribution now zero?

MR. WELLER: I think there is a specific sentence in the 401(l) regulation, as amended, which says that if the base turns out to be negative, then you can't have penny disparity. In other words, there's a two-for-one rule in 401(l) in general, and you use the employer-provided benefit. So if the employer-provided benefit is 0.5%, then the excess benefit is limited to twice that or 1.0%. And if the employer-provided benefit is less than zero, then the excess benefit is also going to be limited to the base benefit. So you can't integrate in that case if you have no employer-provided benefit.

FROM THE FLOOR: In the example that you gave, as you pointed out though, the base is 0.5% and the excess is one in the form that's in place. But the employee contribution rate, what I'm to subtract, is say 1.2%.

MR. WELLER: You are not going to be satisfying 401(l). And if you have a disparity and you're not satisfying 401(l) you are not in a safe harbor. You may be able to do something in a 401(a)(4) general test. But I think you're going to run into the same problem there because the general test is based on the same amount of disparity as in 401(l).

FROM THE FLOOR: The question when you do this is whether you can get a negative number. Do you have a 401(a)(4) safe harbor? That's the question, is it not?

MR. ETHAN E. KRA: They both end up negative, getting zero from the employer on both pieces. So wouldn't that comply? In other words, he said it's a 0.5%, 1.0%. The contributions are worth 1.2%. So when you subtract you get negative 0.7% on the base, negative 0.2% on the excess above the break point. Effectively it's 0% because you never take money away from an employee.

MR. WELLER: I disagree with you. Effectively it's 0%; you don't worry about it. I think what you're doing here is creating a disparity when you don't have an employer base amount. I don't think that's going to satisfy 401(a).

MR. KRA: Because you're worrying about what happens as this carries forward into future years?

MR. WELLER: The exact reason is hard to explain. You can clearly see that if you went down to zero on the base, then you should be able to only have zero on the excess. If you suddenly get below zero on the base, you don't have to worry about the difference between the base and the excess not making any sense at all.

FROM THE FLOOR: Suppose it's a nonintegrated plan—say it was just 1% flat.

MR. WELLER: The regulation says if it's not an integrated plan—this would be in Section 6—then you don't have to do the subtraction in the first place. What's the whole point of the subtraction to both the base and the excess? Let's say you started with the formula that was 1% base, 1.5% excess, that looks like a good 401(l) formula. But, in fact, what's happening is the employee is paying for 1% of total, and the employer is providing zero base and 0.5% excess. That's not a good formula. So it only becomes a relevant issue when you go into the integration question.

FROM THE FLOOR: You're saying that regulation Section 1.401(a)(4)-6 is only on integration?

MR. WELLER: The mandatory adjustment to the benefit accrual rate is only there in the safe harbors that integrate or use permitted disparity. I can't remember for sure whether you use a general test without permitted disparity or whether you have to make that subtraction, but I don't think it becomes an issue then. The subtraction is there to deal with the integration problem. Because if you're subtracting the same percentage from everybody, it shouldn't affect nondiscrimination in general, unless you were depending on integration.

MR. KRA: There are plans that were merged out of existence during the remedial amendment period; in other words, we started January 1, 1989 and a big conglomerate had five pension plans. Sometime during 1990 or 1991 it realized that with all these rules, it was going to be much simpler if we just merged them. But for the period 1989–90 with good faith, we're OK. But going forward, let's make life simple. Then they merged, let's say, effective January 1, 1992. Along comes 1994, and there's only one plan in existence at that moment in time. That plan is being submitted clearly for a determination letter. Does each of the other plans have to be submitted separately, or should they all be submitted along with the package of this merged successor plan? In other words, how many submissions do you need?

MS. MARTICELLO: I'll take a crack at it, and then Harlan can chime in if he wants to. If you go by the letter of the regulation under 1.414(l)-1, when you do a merger you have taken entities X, Y, and Z and you have created a totally new entity W. So essentially you have terminated these three plans as you merged into the new plan. So if you are looking for a determination letter for the merged plan, I think that you also would need to have some assurance of the qualified status of the plans prior to the merger for the years prior to the merger.

Now if you look at it from not quite such a technical standpoint, you could look at the plan that received the other plans as an ongoing entity for all of the years. However you wish you would amend for good faith for a certain period and for whatever you

wanted to do. But I don't think that would get you off the hook for fixing up the plans that you merged into the new plan separately for the period prior to the merger.

MR. WELLER: Certainly if you want to be safe you would request determinations on all of those. You don't want to merge a nonqualified plan with a qualified plan. For the security of getting the determination letter, you would send them all in. Remember, determination letters are there to help you sleep at night. They're not required, but they're assurance that your plan has met certain form requirements.

FROM THE FLOOR: June 30 is coming up quickly. Could you respond to the real value, if any, of the extended reliance period? How much response do you think you'll have for plans filing in order to get that?

MS. MARTICELLO: I don't know the number of plans that have filed by June 30 or intend to file by June 30 to get the extended reliance period. I hope that it is a popular option and that many plans will do it. I did have one conversation with a tax practitioner early this week who was specifically asking me if I thought that the deadline would be moved. I told him I didn't think so. He and his people were working feverishly to have their submissions in by June 30. So at least that practitioner is interested in the extended reliance period.

MR. WELLER: I think the value is a function of how often you come in. If you are a large employer that's constantly buying and selling divisions and merging them and spinning them off with your plan, you're routinely coming in for determination letters every year anyway, and you don't particularly get any value from an extended reliance period. If you're a smaller employer who tries to stay away from the IRS as much as possible because you don't like to pay your lawyer's bills or whatever, it might be worthwhile to do what you can to avoid having to come back in any time in the next five years.

As you may recall, the extended reliance period gives you a pass on coming in. I think the intent is even if we have legislation, you'll have to operationally comply with legislation but you won't have to amend your plans during that period until the XRP runs out.

FROM THE FLOOR: In doing the average benefit test, let's say you have a group of nonexcludable employees who are not covered by any plan. Instead of using zero as their accrual rate, could you impute disparity for them? And why not?

MR. WELLER: If they're getting zero, then when you impute their disparity they still end up with zero because of the two-for-one rule.

MS. MARTICELLO: Because two times zero is still zero.

MR. BRYSON: It's the lesser of the...

MR. WELLER: You're going to end up with $2 worth from it; you're not going to get a whole lot out of it.

MR. BRYSON: Let me ask a question. The session on late breaking developments introduced the 1994 group and unisex pension (UP) tables. They aren't officially out yet, but they are expected to be out some time in the near future. Any plans to include either of those tables in the safe-harbor actuarial assumptions? And if you haven't thought about it, let me urge you to do so.

MR. WELLER: Well, I assume that when those are commonly used we will include them in the standard assumptions. A big issue that has come up in the context of the PBGC legislation is that there's a proposal to require the mortality table that is specified under Section 807(d)(5) of the Code to be used for current liability determinations. Now that section is one that deals with insurance company reserves. The specific requirement is the group annuity table that is used by at least 26 states, and right now that is the GA83 mortality table. Many people don't like the requirement in the PBGC bill that states they would have to use this GA83 mortality table. We can discuss that if you'd like. But the intent of the way the legislation is written is when a table such as a GA94 mortality table is created, and it gets adopted by at least 26 states as a requirement for reserving, it will then be automatically cross-referenced in Section 807 and be used in the determination of current liability under 412(l).

MR. BRYSON: Well, that doesn't really answer the question that...

MR. WELLER: No. I don't think we'd have any difficulty adding to the list in 401(a)(4). They specifically left room for the commissioner to add to that list; it won't require an amendment to the regulation.

MR. BRYSON: Is there some kind of a notice or announcement?

MR. WELLER: Exactly. It is quicker.

FROM THE FLOOR: Just for a change of pace, let's go back to the nanny tax. Let me give you a sequence of possibilities. My washing machine doesn't work so I call a nearby store that does service. The repairman comes and fixes it in my house. All of this costs more than $50.

MR. WELLER: In that case that is not your employee; that is Sears' employee.

FROM THE FLOOR: OK. I hire someone to paint the inside of my house. He runs his own business, he doesn't work for Sears, he's self-employed.

MR. WELLER: He's probably an independent contractor. You may note that these all become interrelated. That's one of the controversial issues of the health package. The Treasury Department has proposed changes in the rules about who's an employee versus who's an independent contractor.

FROM THE FLOOR: But I'm wondering about the present rules, because these are real issues.

MR. WELLER: Under the present rules, whether that person is your employee or an independent contractor is based on a 20-factor test laid out in the revenue ruling that's on a very facts-and-circumstances-oriented basis. It has to do with things like

who provides the tools, who sets the procedure. A painter who brings his or her own paint and all his own equipment and does this for everyone else, and routinely holds himself out as a painter, is going to be an independent contractor. This is a little afield for my specialty.

FROM THE FLOOR: So what is the revenue ruling or the list of 20 factors? Where do we find the list of 20 factors?

MR. WELLER: I cannot recall the name of the revenue ruling. It's a long-standing list of factors and it was developed by the Service from a series of cases.

FROM THE FLOOR: If you're going to file by June 30 or even by December 31 and use the "(a)(4)" general test, or even for 410(b), use 1992 data for your test is that too old? I know that you have to certify in the filing package that your data are the most current data.

MR. WELLER: Are we talking about if you're testing for the 1992 formula that was in place in 1992?

FROM THE FLOOR: Yes. And the data are from 1992. I guess I'm questioning whether the input data have to be most recent or the output data from the test or exactly what that means.

MR. WELLER: I don't have an interpretation of that. There is the question of how much reliance you get on the determination letter when in fact you are subject to demographic variation. If you're getting a determination the way you're doing the computation is good. If you have say a general test, your plan design may be exactly the same in 1993 or 1994 as it was in 1992. The number of people you have in 1992 and the particular demographics supported that you passed the general test in 1992. You might have a completely different result in 1993 or 1994. Whether we're going to find that result, given that we have the issue of substantiation quality data, is a practical kind of problem. But with a theoretical problem, you have more of a reliance that you're doing the proper procedures than you have a reliance that "don't worry about changes in demographics from the point of time that you did your demonstration."

MS. MARTICELLO: I definitely agree with Harlan on that. And if you look at Revenue Procedure 93-39, it specifically says you can't get reliance on whether your data are of substantiation quality. So generally when we've looked at these applications in the national office, we only look at the methodology. We believe the data, unless there's something glaring that we see. But we're not giving any reliance as to anything but the methodology for passing a test.

MR. WELLER: I think you'd have difficulty in June 1994, if it's done based on calendar-year 1992 data. I think the agent might ask you where 1993 is.

FROM THE FLOOR: If you have an employee who is being limited by the $150K cap and you want to have the with wear-away fresh start and you also want to have compensation adjustments, can you have the compensation adjustments just apply to

the 401(a)(17) group? If it's a fresh start that's effective December 31, 1993, which is before the effective date of the TRA 86 regulations?

MR. WELLER: If they're the only people who are getting the fresh start you can provide the compensation adjustments for them. If everyone is getting a fresh start, you have a consistency requirement. Everyone has the same compensation adjustments. The intent of the Section 401(a)(17)-only fresh start is to deal with situations in which your plan is otherwise in compliance except for this one element. You don't want to upset the apple cart of the benefit levels for everyone else or complicate the way the benefit is computed merely because you're making this change for some 401(a)(17) employees. But if you're making across-the-board changes, then you need a consistency on doing the past compensation upticks.

MR. KRA: Harlan, I think the list of required modifications specifically have language that do exactly what you described—that index only the people who are over $150,000 and leave everybody else alone. So that's in standard language that the Service has provided.

MR. WELLER: But is it dealing with the case where everyone's getting a fresh start at once?

FROM THE FLOOR: No. It's only the $150,000 employees who get a fresh start.

MR. WELLER: If only the $150,000 employees are the ones who are getting the fresh start then you can give them compensation upticks.

FROM THE FLOOR: The regulation on suspension of benefits under ERISA Section 203 covers people who retire and return to work, but it also covers people who continue to work after reaching normal retirement age. It says that the amount of benefit that is suspendable is the employer-derived portion only. Does that mean that when somebody hits normal retirement age, he or she must begin to receive the employee-derived benefit? Or, must the employee-derived portion be given actuarial increases even if the suspension notice is given? Or does it mean something different?

MR. WELLER: I haven't looked at that regulation in recent times. That's a Department of Labor regulation, so it's something I have not dealt with closely.

MS. MARTICELLO: I have had occasion to look at it recently. I think it might even have been somewhat in relation to that issue as to whether a benefit was suspendable. I think that the suspension provisions specifically allow you not to pay an individual's benefit, provided you do give actuarial equivalence for late commencement.

FROM THE FLOOR: But that would imply it's suspendable, otherwise you'd be forced to.

MS. MARTICELLO: Yes. If you come up and give me your phone number, I will go back and look at what I did to see if I can give you a better answer.

FROM THE FLOOR: By the way, another implication is if you do pay and you want to use the amount paid to offset the additional accrual, it's only the suspendable amount.

MS. MARTICELLO: It's the suspendable amount that can be offset. That's right. That's the issue that came up. Precisely.

MR. CRIDER: I'd like to go back to Section 415 and public plans. Just a simple 415 public plan question. Public plans, as I understand them, are not subject to the qualified joint-and-survivor annuity requirement. Many of these plans have a normal form that's a joint-and-survivor annuity. My question is, if a plan does have a joint-and-survivor normal form, if that plan suspends the benefits on the remarriage of a spouse, does that form of benefit fail to be a qualified joint-and-survivor annuity?

MS. MARTICELLO: Well, under general rules, a qualified joint-and-survivor benefit can't be suspended on remarriage. So I think by definition, if your benefit is suspended on remarriage, it doesn't satisfy the definition of a qualified joint-and-survivor annuity. But if you're a public plan, you don't need to worry about that.

MR. CRIDER: Well, but when you go into calculating your 415 limits, on occasion you can ignore a portion of the benefit.

MS. MARTICELLO: Oh, are you talking about the fact that prior to retirement the assumptions were that you use a mortality decrement or not? Is that what you're talking about, whether benefits are...

MR. WELLER: You're talking about the rule that says that if you pay the benefit in the form of a qualified joint-and-survivor annuity you don't have to adjust the limits.

FROM THE FLOOR: That's the issue I'm trying to address. Yes.

MR. WELLER: Again, it's nothing that I've looked into, but I would be hard pressed to say that we would interpret that qualified joint-and-survivor annuity differently for people who aren't subject to the qualified joint-and-survivor annuity rules in the first place. I think, as a policy matter, if we're saying we're giving you a break in 415 if you provide this spousal benefit we want to be consistent, although in the case of these public plans you don't have to provide that spousal benefit in the first place. But it would be inconsistent to say you get the break for providing it but it's not good enough to meet the requirements of a qualified joint-and-survivor annuity. That's just my impression.

MS. MARTICELLO: You may be right, Harlan. I haven't looked into it recently, but I'm not totally sure that I agree. I'd have to look at the regulations. Because now that I understand what your question is, I believe the regulations are specific about what you can ignore for purposes of Section 415. Otherwise, you have to go through a whole rigmarole to calculate the exact...

MR. CRIDER: So you're saying that the remarriage provisions do have the potential to affect the 415 limit.

MS. MARTICELLO: Yes, I think at least they have a potential. I don't have the regulations with me; I would have to take a close look at them. And I'm not sure that you're OK.

MR. KRA: Harlan, at another session you talked about a 401(k) plan with $150,000 limitation. Either you could front load it as the first $12,000 received during the year or you could do $12,500 a month. Does that have to be a plan-specified decision or can that be an individual-by-individual decision? Namely, can the plan allow some people to do the first $150,000 during the year and allow other people to do $12,500 a month for their 6% contribution?

MR. WELLER: I think the plan could have that kind of flexibility. You just have to be a bit cautious. If you're giving the people who are at $150,000 the opportunity to turn on and off their spigot of salary deferrals, everyone else must get equal opportunity to start and stop. If you're indirectly giving them the ability to start and to take the last $150,000 or the first or whatever and things like that, that is a right or feature.

MR. KRA: Nothing that egregious.

MR. WELLER: Well, whatever. I give that as a word of warning. You had better have flexibility for everyone else to start and stop if you're going to give those employees the ability to choose which $150,000 they're deferring out of.

FROM THE FLOOR: Since January 1986, we've been calculating in defined-benefit plans that provide for a lump sum the greater of that provided by the actuarial equivalent or that by the PBGC variable rate interest. Review this, because I'm unable to see the rationale of imposing something that is decided by the PBGC and where the plan sponsor has no control. There's just hardly enough justification for that to happen. Are they seeing from a public policy standpoint that this is bad policy based on the reexamination we did of it.

MR. WELLER: Let me tell you why it's there in the first place and possibly how it could be changed. The origin of the interest rate limitation in 417(e) was to make sure, when you're cashing people out in a lump sum, they get a fair settlement. In the early 1980s, a few employers were using interest rates as high as 15% to cash people out. As you can imagine, their lump sums became very small. So Congress stepped in and said, "We need to define a fair settlement." And then they looked at it and they said, "Well, the PBGC is out here defining the present value of a future annuity, so why shouldn't we use that as a standard for the present value?" That's what you're paying them. You're paying them the present value of their annuity. Why should you have a different rate than what the PBGC uses? That was the thinking that went into the 1984 and the 1986 versions of 417(e). When the PBGC changed its interest rates late last year and changed the basis of how it did the calculations, it did not change the way it calculated lump sums because of the interaction with the 417(e) interest rates. It did not want to indirectly affect the 417(e) interest rates.

In the administration's proposal, we have suggested that you cut the tie between the PBGC interest rates and the 417(e) interest rates and suggest that you use solely

30-year treasury rates—an independent index. Interestingly enough, we've also added a requirement that you use a specific mortality table. It seems very odd to specific an interest rate when you're trying to set out sort of a minimum fairness standard without specifying a mortality table. And we use the same mortality table as I talked about earlier in the funding, which is currently the GA 83 mortality tables. So if the administration's proposal became law, lump sums would have to be based on at least the 30-year treasury rate and the GA 83 mortality rather than the PBGC rates.

FROM THE FLOOR: Continuing on with the PBGC interest rates, the qualified J&S form can be no less valuable than the actuarial equivalent of the most valuable optional form. Does that also apply to a lump sum, which may be calculated by using PBGC rates?

MR. WELLER: That does apply to all annuities, to all forms.

FROM THE FLOOR: So if you had a lump sum form, you would first have to calculate how much the minimum lump sum was and then make sure the qualified J&S was at least actuarially equivalent to that inflated amount.

MR. WELLER: Yes. The circle isn't closed in terms of what computation you have to use to determine what interest rate you have to use to determine that a joint-and-survivor annuity is the most valuable.

FROM THE FLOOR: You're saying it's not automatically the factors under the plan.

MR. WELLER: I think you have a little bit of wiggle room there to solve your problem. But I think those facts must satisfy 417(e). The purpose of that kind of rule is you don't want to offer a lump sum at 2% interest. It becomes so much more valuable than the joint and survivor. So no one would take a joint and survivor if he or she were leaving on the table all the extra value implied by using a very low interest rate. So there is an intention that even if you are forced to use a particular interest rate, that you don't create something more valuable than a joint and survivor.

FROM THE FLOOR: As long as we're on that one, general test, most valuable rate, the regulations imply that you should start with the qualified joint and survivor because that's the most valuable. What if the life only is the most valuable between the two different bases that you used, the conversion in the plan to the joint and survivor or the testing basis? Which should you start with, the life only or the J&S?

MR. WELLER: There is the assumption that the J&S is the most valuable. I would probably wonder for sure why you had a life only that is more valuable.

FROM THE FLOOR: Well, the basis in the plan is 6% and unisex pension table (UP-1984) for testing you're using 8%.

MR. WELLER: But why does that make the life annuity more valuable than the joint survivor?

FROM THE FLOOR: The duration is less.

MR. WELLER: So what you're saying is that you've demonstrated that the joint and survivor is equivalent to the life only at 6%.

FROM THE FLOOR: Right.

MR. WELLER: I think once you have that equivalence, the regulation would ask you to use a joint and survivor. If it is equivalent, you might be able to add some interest rate. If you think it's probably a more appropriate result to use, what you think is the more valuable rate, then I'd do it. The regulations got away from the cookbook approach to allow actuaries to use some judgment. And here's an example of where it sounds like your judgment may be to use the life-only approach. But you should be able to justify why you are varying from what the agent is expecting in terms of the joint and survivor.

FROM THE FLOOR: We've been provided the CAP and VCR programs that are supposed to allow sponsors to correct problems. And then the IRS has been indicating that there's going to be, I guess, a harder line approach to enforcement. And it just seems like what's being asked for is perfection in administration, and that seems kind of disturbing. And I wonder if you can comment on that.

MS. MARTICELLO: Certainly the Service wants the highest degree of compliance that we can get, and we are going to enforce as strictly as we possibly can. But I don't think you can say that we're looking for perfection because we do expect plan administrators to keep tabs of the way their plans are running and to sort of self-regulate themselves. That's why we do have administrative policy regarding sanctions. When you say imperfection, into my mind springs the idea of that very minor infraction that you, of course, most certainly wouldn't want to have your plan administrator crucified for. But that's why we have APRS, so that you can come in and fix those things voluntarily with no sanction at all. And even with VCR, if it's a more serious violation, you can come in and get some relief. So nobody expects anybody to be perfect. But the best we can do is give you some opening to correct imperfections. But after all, defects are defects and it's our responsibility to find them and enforce compliance.

FROM THE FLOOR: In determining if you have separate lines of business, there are different methods for doing that. And one of them is if the business falls into the separate groups where it is grouped by the standard industrial classification (SIC) codes. If you have an industry for which the SIC code is not listed in those, can you just not use that method?

MR. WELLER: I thought that we covered all the SIC codes. Are you telling me we missed some?

FROM THE FLOOR: Maybe.

MR. WELLER: I can't recall.

FROM THE FLOOR: What you're telling me is it was meant to be comprehensive.

MR. WELLER: All industries went into one code or another. Admittedly, we collapsed 90 potential two-digit codes into smaller groups. I don't think that it was intended to move any out. But it's a little bit old in my mind; it has been three years since that was done, and I can't answer it for sure.

MR. KRA: Just a quick one. Are the local offices sending cash-balance plans into national, or are they going to get determination letters locally? There have been rumors that they're all going to be shipped to the national office.

MS. MARTICELLO: As far as I know, there's no requirement for either a mandatory technical advice request for a cash-balance plan or that a determination request for a cash-balance plan be sent to the national office. If agents have trouble with these issues, they will be more likely to ask for technical advice from the national office on a cash-balance plan. But definitely there is no requirement that all cash-balance plans be sent to the national office.

MR. KRISHNAMURTHY: We haven't talked about cross testing. Where does it stand actually?

MR. WELLER: Where it stands at this point is, in the PBGC proposal, the administration would prohibit all cross testing. Since that time, we heard from more than one person who didn't like that position. We have been talking with people in the pension community, we've also been talking with the staff of the committees on the Hill. And it's sort of an informal process at this point. As they hear from some of these people, they're getting our reaction to some of the ideas. But at this point, it is in the Hill's court. They are the ones who are going to open up the door to allow more cross testing than what the administration would propose.

MR. KRISHNAMURTHY: I want to just make a couple of comments on cross testing. The target plan is a cross-testing plan per se. And, therefore, we must look at the 401(a)(4) regulations producing a wider foundation for abuse. It's not the cross testing, but it's the concentration test and the failure to look at the concentration test and the various tests that go to it. So I submit that the IRS should reexamine the 401(a)(4) cross-testing regulations and make it such that it is nonabusive. It's not a statutory issue but rather a defective regulation that produces abuse. I submit that a good look at it again will produce better regulations that we can live with. And I believe the age-weighted profit-sharing plan, which is the target plan with a different coat on, is the thing that from a public policy standpoint we are to look at carefully.

FROM THE FLOOR: If the otherwise calculated due date for the required quarterly contribution falls on a weekend or holiday, does it move back to the next business day?

MR. WELLER: I believe the statute refers to principles similar to the estimated payments, and I think that is the result.

FROM THE FLOOR: So it's in the statute.

MR. WELLER: It's similar to a cite for 6,000 or 7,000. I can't remember exactly. If you follow that, you'll see that you get the next business day.