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CC:PA:LPD:PR (REG-130241-04)
Room 5203
Internal Revenue Service
1111 Constitution Avenue
Washington, D.C. 20224

RE: Comments on Proposed Rules Regarding Maximum Benefits and Contributions under Code Section 415

I appreciate this opportunity to provide comments regarding the proposed regulations regarding maximum benefits and contributions under code section 415.

I am owner and chief actuary of Piper Pension & Profit Sharing, an actuarial consulting and pension and profit sharing administration firm based in Culver City, California. We provide administration and actuarial services to approximately 300 clients who are small businesses and provide actuarial services to approximately 300 more small businesses who are clients of other administration firms. Currently I am a member of the Board of Directors of the American Society of Pension Professionals and Actuaries (ASPPA), and helped to write many of their comment letters during the period when I served on ASPPA's Government Affairs Committee. However, this letter is not written on behalf of ASPPA but is instead written on behalf of my own small business clients and their employees.

The essence of my comments is that there are fatal flaws in the proposed regulations which undermine the stated purpose of updating the regulations for accumulated changes due to changes in the law and resolution of ambiguities. Two proposed provisions reverse the positions taken by existing final regulations without a change in law and changes to historical Service positions regarding the effect of prior distributions violate both actuarial standards and the law. My hope is to convince the regulators to rewrite the errant provisions so as to not only accomplish the stated purpose of the regulation but, moreover, preserve and enhance the credibility of the Treasury Department and the Service.

Two Provisions Which Typify Correct Interpretation

The late Democratic Senator Sam Ervin, who chaired the Watergate hearings, once said a "judicial activist … is a judge who interprets the Constitution to mean what it would have said if he, instead of the founding fathers, had written it." He might have also said that a regulatory activist is a regulator who interprets the law to mean what it would have said if he, instead of Congress, had written it.

The following two provisions are ***not*** the result of regulatory activism but, rather, are examples of

careful and responsible interpretation of the law.

The first example of proper regulatory interpretation is the new definition of years of participation. The proposed regulations clarify that to earn a year of participation for purposes of Code Section 415 an employee must be credited with at least the number of hours of service which would enable the employee to earn a benefit accrual (whether or not the employee actually earns an accrual) and must have been a participant for at least a day during the year. This prevents a plan from requiring a lower hour threshold for granting a year of participation for Code Section 415 purposes than for benefit accrual service. However, the proposed regulation is restrained in that as much liberty is granted as possible to the plan sponsor in the choice of the hour threshold.

There remain some ambiguities which should be addressed in final regulations, such how to identify the hour threshold for a year of participation for purposes of Code Section 415 when there are different hour thresholds for different benefit structures within the same plan.

The second example of proper regulatory interpretation is the section where the proposed regulation allows a plan the ability to provide a partial lump sum benefit and yet subsidize the remaining portion of the maximum annual benefit in the form of a qualified joint and survivor annuity. Here the regulators have demonstrated one of the basic rules of interpretation: namely to seek the full intent of Congress. Congress wanted to encourage qualified joint and survivor annuities but not to punish those participants who take lump sums, because to punish participants who take lump sums would conflict with another goal of Congress, that of pension portability. The intent of Congress would have been undermined if a small payment subject to the rules of Code Section 417(e), such as a partial lump sum, had been allowed to prevent a participant from reaping the QJSA subsidy.

Notice that the two good examples share a number of qualities, not the least of which is restraint from unduly restricting the liberty of the plan sponsor and participant to make choices. Now I will regretfully address a series of instances where the regulators did not properly interpret the law in crafting the proposed regulations and, moreover, did not demonstrate proper restraint.

The Proposed Use of Code Section 401(a)(17) Limitation in Code Section 415 Applications

That the proposed regulations could contend that the compensation limitation of Code Section 401(a)(17) is also a limitation on benefits under Code Section 415(b) is absolutely astounding. Let us first review some history.

Code Section 401(a)(17)(A) says,

> A trust shall not constitute a qualified trust under this section unless, under the plan of which such trust is a part, the annual compensation of each employee taken into account under the plan for any year does not exceed $200,000.

The limitation of IRC Section 401(a)(17) was first imposed by TRA ’86 effective in 1989 at an amount of $200,000, lowered by OBRA ’93 to an amount of $150,000, and subsequently raised by

EGTRRA back to $200,000. IRC Section 401(a)(17) was modeled after the $200,000 compensation cap which applied to Top Heavy plans imposed by TEFRA '82 under Code Section 416. Neither the final regulations under Code Section 416 nor the existing final regulations under Code Section 401(a)(17) impose this limitation on maximum benefits and contributions under Code Section 415. There has never been any hint from the Congress, the Treasury Department, or the Service of any such intent despite numerous opportunities to do so. In fact, the question has been asked and answered at conferences countless times, with the answer always being that no such link exists.

The intent of Congress with Code Section 401(a)(17) (and the earlier Top Heavy limitation of Code Section 416) was only to limit the compensation used for purposes of nondiscrimination and deduction purposes and not for maximum benefit and contributions under Code Section 415. If the final regulations under Code Section 401(a)(17) were incorrect and not broad enough in what the words "taken into account under the plan" meant, Congress has had able opportunity to require a correction through legislation. Congress has not seen fit to do so.

As evidence of Congressional intent, the legislative history of EGTRRA makes a clear distinction between the compensation limit under Code section 401(a)(17) and the maximum benefit limits under Code Section 415. With regard to the latter it says,

> Under a defined benefit plan, the maximum annual benefit payable at retirement is generally the lesser of (1) 100 percent of average compensation, or (2) $140,000 (for 2001).

Congress says neither that there is a third limit of the Code section 401(a)(17) limit nor that the 401(a)(17) limit applies to Code Section 415 compensation. On the contrary, it says,

> Under present law, the annual compensation of each participant that may be taken into account for purposes of determining contributions and benefits under a plan, applying the deduction rules, and for nondiscrimination testing purposes is limited to $170,000 (for 2001). The compensation limit is indexed for cost-of-living adjustments in $10,000 increments.

Note that the legislative language says "for purposes of ***determining*** contributions and benefit" not for "***limiting*** contributions and benefits". Q&A 42 of the final regulations under Code Section 416 uses a similar phrase, "to determine plan benefits". Congress, current final regulations, and all other guidance from the Treasury Department and the Service until this proposed regulation have made a clear distinction between the compensation used for ***determining*** benefits and the compensation used for ***limiting*** benefits. Thus, all of the regulatory and other guidance from the Treasury Department and the Service have allowed a Plan to provide a benefit greater than 100% of the Code Section 401(a)(17) compensation as long as it did not exceed the limitations under Code Section 415 because Code Section 415 compensation is not the same as Code Section 401(a)(17) compensation (or Code Section 416 compensation) and never has been.

The intent of the proposed regulation is to insert the Code Section 401(a)(17) limit into the Code Section 415 calculations by means of the definition of Code Section 415 compensation. Again, that does not reflect the intent of Congress. Code Section 415(c)(3)(A) says, "The term "participant's

compensation" means the ***compensation of the participant from the employer*** for the year." Note that the Code Section 401(a)(17) limitation is not cross-referenced in Code Section 415(c)(3)(A). Congress is not shy about cross referencing when necessary. For example, Code Section 414(s)(1) says, "Except as provided in this subsection, the term "compensation" has the meaning given such term by section 415(c)(3)." The implication is that Code Section 415 compensation is not limited by Code Section 401(a)(17), otherwise there would be a cross-reference in Code Section 415.

Such implication is evidenced by Regulation 1.414(s)-1(d)(3)(ii)(A) which says,

> Total compensation taken into account for each employee (including, if added, the elective contributions and deferred compensation described in paragraph (c)(4) of this section) may not exceed the annual compensation limit of section 401(a)(17).

Since Code Section 414(s) compensation is already limited by Code Section 415 compensation, the regulations under Code Section 414(s) would not have to reference the Code Section 401(a)(17) compensation limit if the position taken in the proposed Code Section 415 regulation was correct. Since they do, the position taken in the proposed regulations is highly suspect.

The regulations under Code Section 415 are not statutory regulations, namely the type of regulations which allow the Treasury Department and Service to ***write*** the underlying rules, such as the regulations written under Code Sections 401(a)(4) and 414(o). On the contrary, the Treasury Department and Service are only supposed to ***interpret*** the rules written by Congress in Code Section 415. The fact that the legislative history backs up existing final regulations and not the proposed changes should be the determinative factor.

Now I will present three demonstrations of the profound error of the proposed regulations.

First, experienced practitioners in the pension community will remember a concept called "Family Aggregation" introduced by TRA '86. The effect of Family Aggregation insofar as Code Section 401(a)(17) was that aggregated family members had to "share" the compensation limitation under Code Section 401(a)(17). If the proposed regulations are correct now, then Family Aggregation should have limited under Code Section 415 the sum of annual benefits to $150,000 for aggregated family members. For example, say a husband and wife were forced to share the compensation limitation of $150,000 in 1994. If he had W-2 compensation of $200,000 and she had W-2 compensation of $200,000, the result under the terms of the Plan could be that he was allocated $75,000 of the compensation limit and she was allocated $75,000 of the limit. Using the interpretation promoted by the proposed regulation, the maximum benefit payable at age 65 for each of them would have been limited to $75,000 and not to the then maximum dollar limitation of $118,800. The contention that the intent of Congress was to limit the benefits in this example to $75,000 has no merit whatsoever inasmuch as an intent that broad would have been communicated in the conference committee report to either TRA '86 or OBRA '93 and known long before the year 2005.

Second, if the interpretation promoted by the proposed regulation is correct, then whenever a

participant has ten years of participation, the 401(a)(17) limit would apply to benefit commencement ages of 68 and above in place of the Code Section 415(b)(1)(A) dollar limit. By taking the year 2005 dollar limitation of $170,000, multiplying it by the age 65 straight life annuity purchase rate of 12.252, accumulating the result to age 68 at 5% interest, and dividing by the straight life annuity purchase rate at 68 of 11.344, the result is $212,548. This exceeds the average of the Code section 401(a)(17) compensation limits for 2003, 2004 and 2005 which is $205,000. So the proposed regulation is contending that the adjustments in the law to the dollar limitation for benefit commencement ages above 65 were only meant to be generally relevant for two benefit commencement ages, namely 66 and 67. It is stunning to even think of so much legislation and guidance written for just two benefit commencement ages.

Furthermore, since this new rule only affects ages 68 and above, it seems highly ***age discriminatory***. One would think the Treasury Department and the Service would be sensitive to possible age discrimination issues after the flap about Cash Balance plans.

Third, the proposed regulations say that the Code Section 401(a)(17) limitation applies to the annual addition limitation calculation for defined contribution plans. In particular, a participant cannot receive a larger annual addition than 100% of the compensation paid to a participant during the ***Plan year***. This seems to conflict with the final regulations under Code Section 414(s). The 414(s) regulations clearly allow (as one of many options) the use of W-2 compensation paid for the Calendar year which ends in the Plan year. The Code Section 414(s) regulations cannot be read to limit 414(s) compensation to just the period of the Plan year. Further, the proposed regulations create a trap for the unwary, wherein someone could have $42,000 of compensation during Calendar year 2007 and yet have $10,000 during the Plan year ending June 30, 2008, thereby being limited to an annual addition of $10,000 rather than $42,000. Finally, the notion to limit the compensation during the Plan Year seems to conflict with the requirement to use the Limitation Year as the period of measurement.

The proposed regulations extending the limitations of Code Section 401(a)(17) to Code Section 415 are unreasonable and are contradicted by the law, Congressional intent, and existing final regulations.

The Proposed Exclusion of Pre-Participation Compensation from the Average Compensation Limitations of Code Section 415

The proposed regulations reject the position taken by the current final regulations under Code Section 415 that the compensation used in the determination of the highest three years of compensation is compensation while in the service of the employer. The proposed regulations state that only compensation while a participant is used.

There is some basis in the words used in Code Section 415(b)(3) for the interpretation put forth by the proposed regulations. The Code says,

> For purposes of paragraph (1), a participant's high 3 years shall be the period of consecutive

> calendar years (not more than 3) during which the participant both was an active participant in the plan and had the greatest aggregate compensation from the employer. In the case of an employee within the meaning of section 401(c)(1), the preceding sentence shall be applied by substituting for "compensation from the employer" the following: "the participant's earned income (within the meaning of section 401(c)(2) but determined without regard to any exclusion under section 911)".

Code Section 415(b)(3) seems to say that the period containing the compensation must be a period during which the employee was an active participant. However, the regulators assume that Congress meant the same thing by the term "active participant" as does today's benefits community. I have a better explanation for the term than that which the proposed regulations put forth.

But first, there is a section of Code Section 415 which has language in apparent conflict with Code Section 415(b)(3). Code Section 415(f)(2)(B) says,

> In applying subsection (b)(1)(B) to the aggregate of such defined benefit plans for purposes of this subsection, the high 3 years of compensation taken into account shall be the period of consecutive calendar years (not more than 3) during which the individual had the greatest aggregate compensation from the employer.

"The period of consecutive Calendar years (not more than 3) during which the individual had the greatest aggregate compensation ***from the employer***" is the term used by this part of Code Section 415 and clearly refers to compensation paid during ***all*** periods of employment and not just during periods subsequent to the employee's **entry date** into the Plan. There is no other reasonable way to interpret that language.

There seems, then, to be a contradiction in the law, and thus, an ***ambiguity*** which must be interpreted.

Fortunately, we are not sitting in 2005 interpreting this thirty-year old ambiguity for the very first time. This ambiguity has already been interpreted by the Treasury Department and the Service, first by Revenue Ruling 75-481, then by proposed and final regulations under Code Section 415, and finally by every single issue of guidance since then. All guidance has, until now, been clear. All prior guidance, including the final regulations, allowed the use of compensation during all periods of employment with the employer and not just "years of plan participation".

To assume that the writers of the Revenue Ruling and the original Regulation were 180 degrees off is to assume that they either didn't know what they were doing or, else, were regulatory activists. On the contrary, I assume they both knew what they were doing and were following the intent of Congress. The Federal Courts have given deference to their interpretation of the law for twenty five years. Taxpayers have relied on their interpretation of the law for thirty years. Congress has had thirty years worth of opportunities to correct this interpretation if Congress had thought it incorrect, but Congress has not done so, lending credibility to the thirty year position of the Treasury Department and Service. As a matter of record, Congress has modified Code Section 415 at least

five times since ERISA and yet has not seen fit to change Code Section 415 to require a modification of the regulations on this issue.

Here is another fact: the regulators of twenty five years ago were much better qualified to discern the intent of the Congress in enacting ERISA than are the regulators of today. They could speak to the members of Congress who enacted ERISA. They could speak to Congressional staff who wrote the nuts and bolts of ERISA. They were there. Current regulators were not there.

Now let us consider a possible explanation for the resolution of the ambiguity in favor of the final regulations. Congress allowed and still allows for the accrual of past service benefits. In fact, prior to TRA '86, the Code Section 415 dollar limitation was reduced for years of service less than ten rather than by years of participation less than ten. For example, an employee with ten years of service prior to the adoption of a defined benefit pension plan, who earned enough compensation, could have earned the maximum dollar benefit available under Code Section 415 as of his first day of entry into a defined benefit pension plan. If Congress had allowed the complete accrual of the maximum pension benefit without more than a day of participation but, then limited the average compensation to just compensation earned since the first day of plan entry, the whole concept of past service benefits would have been wrought with contradictions.

Furthermore, such a limited interpretation would have completely prevented defined benefit pension plans from providing past service benefits since 1975 to employees not in service as of the effective date of the plan. Keep in mind that the exclusive benefit rule limits benefits to employees or their beneficiaries. It doesn't restrict employees to mean only ***current*** employees. Consider the number of former employees who would have been excluded from their employer's new pension plan if these proposed rules had been in effect since ERISA.

I propose that the Treasury Department and the Service might have decided twenty five years ago that Congress intended compensation "while a participant" at the very least to mean compensation during ***credited service years***. For example, Congress intended that an employee who was hired in 1978, entered a Plan in 1979, and earned a benefit for the 1978 year, was an "active participant" for the 1978 year. Retroactive participation is not a foreign concept to the benefits community. Nor was it to the regulators of twenty five years ago.

Why then did the regulators of twenty five years ago not limit the compensation specifically to years of benefit accrual service? Perhaps they thought such would make the rules too complicated. Perhaps since only a stroke of a pen could count any year of service as a year of benefit accrual service, they decided to keep the job of pension administration as simple as possible and let all compensation with the employer be used. Finally, perhaps they considered the fact that the existence of two defined benefit pension plans would trigger Code Section 415(f)(2)(B) and allow the use of compensation during the entire period of service with the employer, so it was inefficient to require an employer to go through the effort necessary to adopt two plans just to be able to make use of this more liberal provision. While we who sit in review twenty five years later may not know precisely why the earlier regulators allowed the use of compensation during all periods of employment with the employer and not just "years of plan participation", we do know that it was the purposeful result of

much consideration since any error so obvious would have been corrected before final regulations were published.

A regulator should be very careful about directly contradicting earlier final regulations. Those prior regulations have been given deference by the Federal Courts for twenty five years. They have been relied upon by taxpayers for twenty five years. Moreover, I have shown that the position of the proposed regulations is not the only reasonable interpretation of the letter of the law, so the final regulations are not obviously incorrect. Finally, let us not forget that when current regulators seek to undermine the credibility and legitimacy of the regulators of twenty five years ago, they undermine their own as well.

The Use of Incorrect Actuarial Functions

In all of the examples which call for the calculation of the value of the maximum annual benefit, the proposed regulation uses the wrong actuarial commutation functions, i.e. it uses the actuarial commutation functions for a monthly benefit rather than for an annual benefit.

IRC Section 415(b)(1) says, in part,

> (1) In General
> Benefits with respect to a participant exceed the limitation of this subsection if, when expressed as an ***annual benefit*** (within the meaning of paragraph (2)), such annual benefit is greater than the lesser of--
>
> > (A) $160,000, or
> > (B) 100 percent of the participant's average compensation for his high 3 years.
>
> (2) Annual Benefit
> > (A) In General
> >
> > For purposes of paragraph (1), the term "***annual benefit***" means ***a benefit payable annually*** in the form of a straight life annuity (with no ancillary benefits) under a plan to which employees do not contribute and under which no rollover contributions (as defined in sections 402(c), 403(a)(4),403(b)(8), 408(d)(3), and 457(e)(16) are made.

The law does not say weekly, semi-monthly, semi-annually or monthly. It says annually. This means the use in actuarial calculations of the commutation function N and not the modification pronounced "N upper 12". To use "N upper 12" results in a smaller lump sum value than does the use of N.

To use an N upper 12 is just plain wrong for an annual calculation. It would be the same as if the U.S. Army Corps of Engineers wrote regulations requiring that the value of the number pi be fixed as equal to 3 instead of 3.14 etc.. If they did something so stupid, they would become the laughingstock of the Western World. Just as pi is not the same as 3, annual is not the same as

monthly and N is not the same as N upper 12.

Examples in regulations should be in terms of annual benefits and use the proper actuarial functions.

The Use of the Wrong Mortality Table

Code Section 415(b)(2)(E)(v) says,

> (v) For purposes of adjusting any benefit or limitation under subparagraph (B), (C), or (D), the mortality table used shall be the table prescribed by the Secretary. ***Such table shall be based on the prevailing commissioners' standard table*** (described in section 807(d)(5)(A)) used to determine reserves for group annuity contracts issued on the date the adjustment is being made (without regard to any other subparagraph of section 807(d)(5)).

However, the proposed regulation says, for example, in the calculation of the maximum dollar limitation for benefit commencement ages less than 62 to use the benefit which is the greatest of the equivalent to an annual benefit of the maximum dollar benefit payable at age 62 using the Plan's actuarial equivalence or 5% interest and the applicable mortality table. The Plan's actuarial equivalence can include a mortality table different than the applicable mortality table.

This is directly contrary to the text of the Code. There could be a practical reason for the deviation, such as making the work of the Service easier or plan administration easier. However, because these proposed regulations are purportedly trying to adhere more closely to the literal language of the Code in the calculation of the maximum average compensation, despite the horrific cost to taxpayers who have relied upon twenty-five year old final regulations, there seems to be an inconsistency in the flexibility of applied interpretation.

Unreasonable Discrimination Against Prior Distributions

Code Section 415(b)(2)(B), (C), and (D) say,

> (B) Adjustment For Certain Other Forms Of Benefit
>
> If the benefit under the plan is payable in any form other than the form described in subparagraph (A), or if the employees contribute to the plan or make rollover contributions (as defined in sections 402(c) , 403(a)(4),403(b)(8), 408(d)(3), and 457(e)(16)), the determinations as to whether the limitation described in paragraph (1) has been satisfied shall be made, in accordance with regulations prescribed by the Secretary by adjusting such benefit so that it is ***equivalent*** to the benefit described in subparagraph (A). For purposes of this subparagraph, any ancillary benefit which is not directly related to retirement income benefits shall not be taken into account; and that portion of any joint and survivor annuity which constitutes a qualified joint and survivor annuity (as defined in section 417) shall not be taken into account.

(C) Adjustment To $160,000 Limit Where Benefit Begins Before age 62

If the retirement income benefit under the plan begins before age 62, the determination as to whether the $160,000 limitation set forth in paragraph (1)(A) has been satisfied shall be made, in accordance with regulations prescribed by the Secretary, by reducing the limitation of paragraph (1)(A) so that such limitation (as so reduced) equals an annual benefit (beginning when such retirement income benefit begins) which is ***equivalent*** to a $160,000 annual benefit beginning at age 62.

(D) Adjustment To $160,000 Limit Where Benefit Begins After age 65

If the retirement income benefit under the plan begins after age 65, the determination as to whether the $160,000 limitation set forth in paragraph (1)(A) has been satisfied shall be made, in accordance with regulations prescribed by the Secretary, by increasing the limitation of paragraph (1)(A) so that such limitation (as so increased) equals an annual benefit (beginning when such retirement income benefit begins) which is ***equivalent*** to a $160,000 annual benefit beginning at age 65.

The word equivalent is meant by Congress to mean actuarially equivalent. It does not mean equivalent to its weight in ounces; it does not mean equivalent to its distance in miles; and it does not mean equivalent to its food value in calories. It clearly means ***actuarially equivalent*** to its value in dollars.

Actuarial equivalent means something very special to actuaries. Our Societies promulgate Codes of Professional Conduct so that an actuary cannot claim that something really worth $1,000,000 is actuarially equivalent to $1 due to some unreasonable slight of hand.

Under the proposed regulations, it is possible for a participant, Wilson, who wants to change the form of his straight life annuity which began at age 65 to a lump sum form at age 75, to find that his annual benefit of, say, $10,000 per year has absolutely no lump sum value. See Appendix A for a numerical example. Wilson's lump sum form of benefit is not ***actuarially equivalent*** to his life annuity form by any stretch of the English language.

When discrepancies like this occur in application of a theory, it is a clear sign of a fundamental flaw in the theory. In this case, the flaw is that the determination age for the calculation of new or changed benefits is being made as of the older, attained age of participant Wilson rather than as of the age at which the first benefit actually commenced.

The regulations excuse this lack of equivalence in their method by saying "there may be a forfeiture of a participant's accrued benefit in violation of section 411(a) in some cases where a participant converts annuity payments to a single-sum distribution". That is an incorrect application of forfeiture under the rules of Code Section 415.

While there are various methods of forfeiture of benefits allowed under the Code, there is only one

method allowed under Code Section 415. That is when a participant has passed up the opportunity to ***initiate receipt*** of an annual benefit he could have begun in a particular year which cannot be increased actuarially in the following year to make up for the missed opportunity. Thus the amount of the annual accrued benefit or benefit limit is not forfeited; only the value of the annual payment or benefit limit remaining is allowed to be of less value than it was a year before, and this is due solely to the attainment of an older benefit commencement age. The first example is when a participant passes up the commencement of an annuity of the maximum dollar benefit of $170,000 payable at age 62 and decides to wait until age 63 or later to commence receiving the benefit. The second example is when a participant could elect to receive at a specified age an annual benefit of 100% of the average of his or her highest three consecutive years of compensation but decides to delay commencement until a later age. The regulation is incorrectly trying to stretch the limited situation allowing forfeitures under Code Section 415 to encompass situations in which the participant earlier received benefits.

The real life consequences of this rule would be disastrous. A firm with a defined benefit pension plan would rarely be able to rehire a valuable former employee who had earlier taken a lump sum or other form of benefit since he or she might forfeit future benefit accruals, thereby thwarting Congressional policy promoting pension portability. Small employers will rarely be able to sponsor a second defined benefit pension plan if they had earlier terminated one. And once a small business owner attains age 70-1/2 and must commence minimum distributions, in order to avoid the forfeiture of accrued benefits he will be apt to terminate the plan, depriving his employees of their future potential benefits.

The proposed regulation is erroneously valuing a stream of payments in a way not intended by the law. The mechanism the proposed regulation uses to make this incorrect distinction is to create an annuity starting date for each series of payments and then claim that the Code Section 415 limits are applied as of the last annuity starting date. An annuity starting date can be described a number of ways: it is the date at which the pre-retirement survivor annuity rules no longer apply and the qualified joint and survivor annuity rules apply; for lump sums, it is the date at which all requirements have been met to pay the lump sum distribution; and it is the date at which the election of the retirement benefit is irrevocable. It is misconceived to use the payment of a lump sum benefit at one annuity starting date to cause a forfeiture of accrued benefits at a later, second annuity starting date. Congress did not say to determine the maximum benefit where benefits end or anywhere in between the beginning or end, but, specifically ***"beginning when such retirement income benefit begins"***, namely at the beginning of the stream of payments being limited. Just as multiple defined benefit plans of the employer must be combined for determining the Code Section 415 limitations, multiple streams of payments from one or more defined benefit pension plans must be combined for determining the Code Section 415 limitations. If multiple streams of benefit payments are being combined for purposes of determining the Code Section 415 limitations, "***beginning when such retirement income benefit begins***" must mean as of the beginning of the ***first*** payment stream. To choose any other point of time for testing and thereby achieve unreasonable results would not only violate the clear language of the statute but also the intent of Congress that alternative forms and timings of benefit payments be actuarially equivalent.

The benefit limit which ***should*** be the measure of compliance is the actuarial equivalent of a stream of future contingent payments representing the maximum annual straight life annuity, valued as of the initial benefit commencement age, adjusted for the following:

1. Cost-of-living increases in the maximum dollar limitation;
2. Increases in the average compensation limit;
3. Additional years of service and participation;
4. Changes in the maximum dollar limit due to changes in law.

This stream of payments would represent the maximum annual amounts which the participant could have received from the Plan had the maximum limit been paid "***beginning when such retirement income benefit begins***", which again is the exact language from Code Section 415.

Effect on Required Distributions under Code Section 401(a)(9)

In proposed regulations 1.401(a)(9)-6, the Treasury Department and the Service incorrectly concluded that Congress intended not only a required ***amount*** of benefit must be paid in a year for certain participants in defined benefit pension plans but, also, required that the ***form*** of the minimum benefit must be a qualified joint and survivor annuity. After input from the public, notably ASPPA, the error was corrected in final regulations.

The final conclusion of the Treasury Department and Service was that Code Section 401(a)(9) required minimum ***amounts*** which must be paid and did not impose a required ***form*** of benefit. The Treasury Department and the Service have proposed a way using Code Section 415 to get the same results as initially envisioned by the incorrectly proposed Code Section 401(a)(9) regulations. Should a participant take his required distributions in the form of a life annuity (such as a QJSA) or some other allowable pattern of payments commencing at age 70-1/2, then he could suffer a forfeiture of some or all of the rest of his accrued benefits if he wants to change the form of payment at his actual retirement age, and this **despite** the provision in the Code Section 401(a)(9) regulations allowing him to do so.

Regulators should correct their mistake in the same way as they corrected it in the final Code Section 401(a)(9) regulations, i.e. by providing maximum liberty to plan sponsors and participants in the choice of the form and timing of a benefit by making the maximum benefit limit for all forms and timing of the benefit limit actuarially equivalent, yet providing the envisioned subsidy for benefits paid in the form of a QJSA.

Inconsistency in the Use of Mortality Discounts

Mortality is not used in the accumulation calculation of the maximum dollar amount for benefit commencement ages greater than age 65. Mortality is also not generally used in the discount calculation of the maximum dollar amount for benefit commencement ages less than age 62.

However, the proposed regulations require the use of mortality accumulations and discounts in

calculating the effect of prior distributions on such maximum benefits "to reflect that the participant has survived during the interim period."

The proposed regulations do not take into consideration whether either the benefits paid or remaining to be paid were subject to the risk of forfeiture on death, which is the sole criteria for whether mortality is used in the calculation of the maximum dollar amount for benefit commencement ages less than age 62.

There should be some consistent thought and application here. The best method is, as stated earlier, to apply all limit calculations as of the original benefit commencement age, the original annuity starting date. If all limitation calculations were performed as of that date, then the actuarial mathematics, including discounts for expected mortality, would flow smoothly and inconsistencies would be eliminated.

Economic Policy

Let us consider the proposed rules from an economic point of view, namely how they might affect the allocation of valuable employees throughout the workforce, keeping in mind that the allocation of scarce and valuable resources is most efficient when choice is made at the lowest possible level rather than by a central bureaucracy.

Assume that you are an employer who is going to create a tax qualified plan to which you are going to make a contribution of 5% of compensation. Do you sponsor a defined benefit pension plan when the Code section 415 rules would punish employees who want to take some of their money as soon as allowed through the use of an unreasonable forfeiture process and when the rules might be changed without a change in law, or do you create a profit sharing plan from which they can take their money pretty much whenever they want, without punishment or forfeiture? If you choose a defined benefit pension plan, any employee who leaves and takes a lump sum benefit will be virtually impossible to rehire, otherwise he or she would risk a forfeiture of future benefit accruals. This is grossly inefficient from an economic point of view.

As either President Bush or Milton Friedman might say, the essence of Freedom is economic ***choice***. Choice should be at the core of any rules written by the Treasury Department and Service. The most efficient way for these rules to work is to leave as much of the choice as possible to the employees and the employer.

Essentially, the rules should move towards providing the same level of employee and employer choice found in defined contribution plans and not discriminate against early payments of lump sums or other forms of benefit from defined benefit pension plans.

Effect on Small Business Defined Benefit Pension Plans

Piper Pension & Profit Sharing

It appears that small plans and plans of professional employers are being picked on again because they make more use of the historical positions being reversed than do the plans of larger employers. The regulators must have known of the hullabaloo the proposed changes would cause in the small plan community. Whether intended or not, the effect of the proposed changes will be to hasten the termination and cripple the formation of defined benefit pension plans of small businesses and thereby garner more tax revenue, all this by a change in regulation rather than by a change in law.

The seeming intent of the proposed regulations to raise taxes is at odds with recent statements by Mr. Steven T. Miller, IRS TE/GE Commissioner who said, “Our focus is not on revenue generation but on ensuring that our customers have what they need to comply.” What his customers need are regulations and guidance that they can rely upon and that won’t be arbitrarily changed every time a new generation of regulators decides that their predecessors incorrectly interpreted the law.

Effective Date of the Regulations

The “proposed” regulations are, in many ways, immediately effective. New plans must follow the proposed rules or risk tax disqualification or forfeiture of accrued benefits in 2007. It appears that existing plans are unable to increase benefits without risking tax disqualification or forfeiture of accrued benefits in 2007. Participants are already suffering harm due to these “proposed” regulations. The regulators should immediately change the effective date for all plans, old or new, to be solely dependant upon the adoption date of final regulations.

Conclusion

My recommendations are:

1. To return to the positions taken by the current final regulations on the determination of average compensation, removing the incorrect reference to Code Section 401(a)(17) and allowing pre-participation compensation to be used in the calculation of average compensation;
2. To value the different forms and timings of benefits for purposes of comparison as of the earliest benefit commencement age, including adjustments such as cost-of-living increases in the maximum dollar limitation in the comparison for all forms of benefit;
3. To accurately reflect the valuation of an annual benefit using annual actuarial commutation functions;
4. To change the effective date for all plans, old or new, to be solely dependant upon the adoption date of final regulations.

Thank you for this chance to comment on the proposed regulations. If you have any questions, please feel free to call me.

Piper Pension & Profit Sharing

Sincerely,

Kurt F. Piper, M.A.A.A., A.S.A., M.S.P.A.
Owner & Chief Actuary

Enclosures: Appendix A (1 page)

Piper Pension & Profit Sharing

Appendix A
Wilson

- **Average of highest three consecutive years of compensation is $10,000**
- **Years of Service and Years of Participation exceed ten (10)**
- **Annual annuity of $10,000 starting at age 65,**
  but cannot get the lump sum equivalent of remaining payments at age 75

Date	Age	Paid	Equiv @ 75 Using 6%	Equiv @ 75 Using 5%
1/1/2004	65	10,000.00	152,946.69	144,981.85
1/1/2005	66	10,000.00	-	-
1/1/2006	67	10,000.00	-	-
1/1/2007	68	10,000.00	-	-
1/1/2008	69	10,000.00	-	-
1/1/2009	70	10,000.00	-	-
1/1/2010	71	10,000.00	-	-
1/1/2011	72	10,000.00	-	-
1/1/2012	73	10,000.00	-	-
1/1/2013	74	10,000.00	-	-
1/1/2014	75			

Value of payments at age 75	152,946.69	144,981.85
Annual benefit @ 75	15,561.00	13,710.00
Larger of Annual benefits	15,561.00	
IRC 415 Dollar Limit	787,520.79	
Remaining 415 Dollar Limit	771,959.79	
High 3 average pay limit	10,000.00	
Remaining High 3 average pay limit	**Zero**	

Notes:

1. The mortality table used is 1994 GAR Unisex
2. The APRs used are not true annual APR, but are (incorrectly) monthly APR divided by twelve.
3. The annual benefits are rounded to the nearest dollar

So Wilson could not get the lump sum equivalent of his annual benefit.