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Terminations

Practitioners Call for Careful Implementation To Avoid Standard Termination Timing Traps

The Pension Protection Act's changes to the minimum lump-sum valuation rules need to be carefully implemented in the context of standard terminations, practitioners told BNA Sept. 12.

The key issue relates to timing, both of the amendment reflecting the new rules and of the termination date of the plan, they said.

''There's a valuable lesson to be learned from the unfortunate experience of many practitioners when they were implementing the GATT lump sum changes,'' Harold Ashner, former assistant general counsel for legislation and regulations at PBGC and now a partner at Keightley & Ashner LLP, a Washington-D.C.-based law firm that specializes in PBGC matters, told BNA.

''Quite a number of practitioners learned the hard way that what works for IRS may not work for PBGC when it comes to the timing of certain plan amendments in standard terminations,'' Stu Sirkin, former policy chief at PBGC and now an executive director in the Compensation and Benefits Group of Ernst & Young's National Tax Office, told BNA.

Lesson from the GATT Changes. GATT is the abbreviation for the Uruguay Round of General Agreement on Tariffs and Trade of 1994 (Pub. L. No. 103-465), which was the legislative vehicle for the Retirement Protection Act of 1994. Among the changes made by RPA were changes to funding rules and to plan distributions.

GATT had reduced minimum lump-sum values by substituting 30-year Treasuries (along with a prescribed mortality table) for PBGC rates as the basis for the calculation, Sirkin said. The change, which generally served to reduce minimum lump-sum values, was statutorily exempted from the anti-cutback rules that prohibit plan amendments from reducing previously accrued benefits. Sponsors often adopted amendments implementing this GATT change, along with other amendments designed to maintain the plan's qualified status, as part of the IRS determination letter process, he said.

These amendments were routinely adopted after the plan's termination date but before the final distribution of assets in the standard termination, with IRS issuing a favorable determination letter based in part on the adoption of the post-termination amendment, Sirkin said.

Practitioners who had their clients adopt post-termination amendments to reflect the GATT lump sum assumptions, and then rely on those amendments to pay lower lump sums, were in for a surprise, Ashner said. Although PBGC rules permit benefit reductions based on a post-termination amendment to the extent the amendment is necessary to maintain a tax-qualified status, PBGC in a number of standard termination audits concluded that these amendments were adopted too late for Title IV purposes, even though they were timely for plan qualification purposes, he said.

The PBGC's reasoning, according to Ashner, was that a post-termination amendment that simply substituted the GATT assumptions for the pre-GATT assumptions was not ''necessary'' to maintain qualified status and therefore could not serve to reduce benefits. The sponsor could have instead added the new GATT assumptions as an alternative basis, but continued to pay lump sums on the old PBGC basis where (as would virtually always be the case) that would produce a larger lump sum. The end result was a PBGC audit finding that lump sums were underpaid and that additional payments had to be made, he said.

According to Sirkin, the PPA lump-sum changes present similar issues in that they generally serve to decrease lump-sum values and are statutorily exempted from the anti-cutback rules. Ashner cautioned that practitioners need to ensure that amendments to implement the PPA lump-sum changes are adopted on or before a plan's termination date to avoid the problems that arose in the GATT context.

New Lesson in PPA Context. Ashner pointed out that there may be a new lesson to learn in the PPA context, given the long period between the August 2006 PPA enactment date and the 2008 plan year effective date of the lump-sum changes.

"The key issue is whether and, if so, how the PPA lump sum changes would apply if a plan with a pre-2008 termination date is amended, on or before that termination date, to reflect the new PPA lump sum rules for the anticipated post-2007 distributions that will be required in order to complete the termination process," Ashner said.

Sirkin pointed out that "this actually may be an IRS issue rather than a PBGC issue because whether a distribution meets the standard termination requirements in this situation is really dependent on how the IRS interprets the lump sum provisions of the Code."

Both practitioners said this issue had been raised at a meeting between representatives of the American Bar Association's Joint Committee on Employee Benefits and PBGC staff. According to the summary of the meeting prepared by JCEB representatives, PBGC staff members then expressed their "preliminary views" that an amendment adopted on or before a plan's 2007 termination date to reflect the PPA lump-sum assumptions "could not be used to determine the minimum value of lump sum payments in the 2008 plan year if such value would be less than the amount calculated using the GATT interest rate and mortality assumptions in effect on the plan's termination date," and stated that "PBGC is considering guidance on the matter."

The Funding Reform Advisory Task Force (FRAT Force) , a group of actuaries, lawyers, and other employee benefit professionals who have gotten together to analyze PPA and make suggestions to the government agencies that will issue guidance, sent a letter to various officials at PBGC, Treasury, and IRS detailing the need for guidance on this and related issues, both Ashner and Sirkin said. The task force letter explained that a "fundamental threshold issue is whether the legal framework governing minimum lump sum values is determined based on the time of distribution (as is the case with the variable interest rate ordinarily used to determine the minimum value) or instead as of the plan termination date."

Both Ashner and Sirkin said they were concerned that with the heavy burden that the agencies have to get out PPA guidance in the next few months, clarifying this issue may not be a high priority.

Pending further guidance, Ashner and Sirkin advise "caution" in dealing with post-2007 lump-sum distributions in a standard termination with a pre-2008 termination dates. They point out that it may be wise to go with a conservative approach, particularly since the dollars involved may not be that significant.

This is because the PPA change to the applicable interest rate, which serves to decrease values, is only partially effective in 2008, while the corresponding and offsetting change to the applicable mortality table, which serves to increase values, is fully effective, they both said.

It may not be too late, even for a pending standard termination, to shift to a post-2007 termination date to ensure the applicability of the PPA lump-sum changes. Ashner suggested that "this can be accomplished by rescinding the old standard termination and simultaneously initiating a new one on an expedited schedule with various time periods running concurrently, although there are some compliance issues to watch out for."

The JCEB summary is available on the ABA Web site at http://www.abanet.org/jceb/2007/PBGC07Final.pdf. The FRAT Force letter is available at http://fratforce.googlepages.com/PPAPlanTerminationlumpsums.pdf.

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