AMERICAN ACADEMY of ACTUARIES

Mr. James E. Holland, Jr.
Manager, Employee Plans, Tax Exempt and Government Entities Division
Internal Revenue Service
SE:T:EP:RA:T
1111 Constitution Avenue NW
Washington, DC 20224

Re: Combined plan limits under Notice 2007-28

Dear Mr. Holland:

The American Academy of Actuaries[1] Pension Committee respectfully requests your consideration of its comments regarding IRS Notice 2007-28 (the Notice). The Notice provides much needed guidance regarding changes to the combined plan deduction limit under IRC section 404(a)(7), as modified by the Pension Protection Act of 2006 (PPA). However, portions of the guidance appear to be inconsistent with the language and intent of the statute.

Relevant Language from Statute and Agency Guidance

IRC section 404(a)(7) limits the total deduction when a sponsor contributes to both defined benefit and defined contribution plans (emphasis added):

> "If amounts are deductible under the foregoing paragraphs of this subsection (other than paragraph (5)) in connection with 1 or more defined contribution plans and 1 or more defined benefit plans or in connection with trusts or plans described in 2 or more of such paragraphs, *the total amount deductible in a taxable year under such plans shall not exceed* the greater of— "

IRC section 404(a)(7)(C) provides that paragraph (a)(7) does not apply in certain cases. PPA added a new exception to the existing list:

[1] The American Academy of Actuaries is a national organization formed in 1965 to bring together, in a single entity, actuaries of all specializations within the United States. A major purpose of the Academy is to act as a public information organization for the profession. Academy committees, task forces and work groups regularly prepare testimony and provide information to Congress and senior federal policy-makers, comment on proposed federal and state regulations, and work closely with the National Association of Insurance Commissioners and state officials on issues related to insurance, pensions and other forms of risk financing. The Academy establishes qualification standards for the actuarial profession in the United States and supports two independent boards. The Actuarial Standards Board promulgates standards of practice for the profession, and the Actuarial Board for Counseling and Discipline helps to ensure high standards of professional conduct are met. The Academy also supports the Joint Committee for the Code of Professional Conduct, which develops standards of conduct for the U.S. actuarial profession

> "(iii) LIMITATION- In the case of employer contributions to 1 or more defined contribution plans, *this paragraph shall only apply to the extent that such contributions exceed 6 percent* of the compensation otherwise paid or accrued during the taxable year to the beneficiaries under such plans. For purposes of this clause, amounts carried over from preceding taxable years under subparagraph (B) shall be treated as employer contributions to 1 or more defined contributions to the extent attributable to employer contributions to such plans in such preceding taxable years."

The concerning guidance from the Notice is captured in Q&A 9:

> Q-9. How does the combined limit of section 404(a)(7) apply when employer contributions to defined contribution plans (other than elective deferrals) do not exceed 6 percent of compensation of participants in those plans?
>
> A-9. When employer contributions to defined contribution plans (other than elective deferrals) do not exceed 6 percent of compensation of participants in those plans, the combined limit of section 404(a)(7) *does not apply to any employer contributions to defined contribution plans*. In such a case, *the combined limit of section 404(a)(7)* (i.e., the greater of 25 percent of compensation, or the contributions to the defined benefit plan or plans to the extent such contributions do not exceed the amount necessary to satisfy the minimum funding standard for the defined benefit plans, treating a contribution that does not exceed the unfunded current liability as an amount necessary to satisfy the minimum funding standard for each defined benefit plan) *applies only to contributions to the defined benefit plans.*

Analysis and Example

Under the statute, the combined limit of section 404(a)(7) applies to the total defined benefit and defined contribution deduction. And the combined limit, the entire paragraph, does not apply in certain cases, including, post-PPA, when the defined contribution amount is less than 6 percent of payroll.

In contrast, the Notice states that even if the defined contribution amount is under 6 percent, the combined limit continues to apply, but only to the defined benefit amount. Applying the paragraph has a significantly different impact, as illustrated with this simple example.

Assume a company with a $40 million payroll sponsors a defined benefit plan with a current liability of $100 million and assets of $100 million. It is clear under both the statute and the Notice that if there is not a defined contribution plan, the sponsor may contribute and deduct enough to fund 150 percent of current liability, or $50 million in this case.

Now assume the sponsor also contributes 1 percent of payroll to a defined contribution plan. Practitioners and plan sponsors operating in real time regarding 2006 tax deductions overwhelmingly interpreted the statute, as modified by PPA, to allow a defined benefit deduction of $50 million in this case, since the defined contribution amount is less than 6 percent.

Under the Notice, however, we get a remarkably different result. The 1 percent contribution to the defined contribution plan would continue to be deductible. But the combined limit under paragraph 404(a)(7) would be applied to the defined benefit amount. The combined limit is based on the greater of 25 percent of payroll, which is $10 million in this example, and the amount to fund 100 percent of the current liability, which is zero. The net effect is that the defined benefit deduction drops from $50 million down to $10 million.

The guidance in the Notice not only appears contrary to the language of the statute, it appears to be in direct conflict with congressional intent. A primary purpose of PPA was to improve defined benefit funding. Deductible limits for defined benefit plans were increased directly through a change in the defined benefit limits and indirectly through the reduced application of the combined limit. Further, while the new structure of the limits is generally effective beginning in 2008, Congress very clearly increased the deductible amounts for 2006 and 2007, presumably so as not to delay voluntary improvements in funding.

Beyond the statute itself, further insight is provided by this excerpt from the Congressional Record of the Senate discussion of H.R. 4. On pages S8755 and S8756, comments made by Sen. Allen to Sen. Grassley are quite clear about the intent of the drafters:

> "However, if an employer has both a defined benefit plan and a defined contribution plan there is a separate deduction limit that applies to employers with a combination of plans. Thus, this legislation in section 803 also updates the limitation on deductions where an employer has a combination of such plans effective for contributions made for taxable years *after December 31, 2005. The change in section 803 eliminates the deduction limit for combinations of defined benefit and defined contribution plans for employers that do not contribute more than 6 percent of compensation to a defined contribution plan."*

Requested Action

The IRS provides tremendous help through its guidance process when the statute is not clear. However, in this situation, there was a widely-held perception in the benefits community that the statute was clear. Notice 2007-28 may be perceived to be inflicting, just days before the deadline (without extensions) for filing 2006 tax returns, an unnecessary and extraordinary hardship on many plan sponsors who are simply trying to do the right thing.

Accordingly, we ask for your consideration of the following suggestions:

- Preferably, revise the Notice to be consistent with the commonly held reading of the statute and the intent of PPA, or

- Alternatively, recognize the difficulty created by this unexpected interpretation. Offer an explanation that helps tie the guidance to the statutory language and, further, provide relief for sponsors who relied on the reasonable interpretation of most of the benefits community and who made contributions before the issuance of the Notice. Sponsors who have made 2006 contributions consistent with what is, at a minimum, a reasonable reading of the statute should be allowed to rely on that reading and retain the 2006 deduction — or at least be given assurance that excise taxes will not apply if the deduction must be deferred.

We thank you for this opportunity to share our thoughts on the exposure draft. If you have any specific questions or would like more information, please contact Samuel Genson, the American Academy of Actuaries' pension policy analyst, at 202-223-8196. Thank you for your consideration of this matter.

Sincerely,

James F. Verlautz, FSA, EA, MAAA, FCA
Chair, Pension Committee
American Academy of Actuaries

Cc: Joseph Grant, Marty Pippins, Tom Reeder, Harlan Weller, Andrew Zuckerman