

# PENSION RIGHTS CENTER

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September 24, 2008

CC:PA:LPD:PR  
Room 5203, Internal Revenue Service  
P.O. Box 7604  
Ben Franklin Station  
Washington, D.C. 20044

Re: Comments on Proposed Regulations on Accrual Rules for Defined Benefit Plans.

We are submitting comments on the Department of Treasury's proposed regulations on certain aspects of the accrual rules for defined benefit plans. The Pension Rights Center is a nonprofit consumer organization that has been working since 1976 to promote and protect the retirement security of American workers and their families.

The proposed regulations consider various problems that occur when a defined benefit plan changes its benefit formula to a new formula—often less favorable to some participants than the former formula—and links the two formulas by providing that a participant receives the greater of the former and new formula.

There are three basic variations of this approach: 1) the former formula is frozen, so that a plan participant thus earns no new benefits until the benefit in the new formula has a greater value than the original formula (hereinafter referred to as “immediate wear-away”); 2) the former formula continues to grow for a period of years, but is frozen at the expiration of this period, so that at the end of the transition period a participant earns no new benefits until the new benefit exceed the value of the now frozen former benefit (hereinafter referred to as “delayed wear-away”); or 3) the former formula continues to grow until an employee reaches normal retirement age, so that a participant receives the greater of the two formulas (hereinafter referred to as “choice at retirement”).

In a revenue ruling issued earlier this year (Revenue Ruling 2008-7), the Internal Revenue Service considered whether these approaches comply with the rules regulating the rate at which participants annually earn the “accrued benefit” under the terms of a plan. One of the positions taken in the revenue ruling was that using the first approach (freezing the former benefit and providing no new benefit accruals until the value of the benefit under the new formula exceeds the value of the benefit under the old formula) will generally satisfy the requirements of the so-called 133 1/3 percent rule, even though some participants accrue zero benefits for a period of years (often referred to as the “wear-away period”). Since this approach generally impacts older employees more

severely than it does otherwise similarly-situated younger employees, it seems particularly odious.

The Pension Right Center wrote a letter to Secretary Paulson, questioning the legal basis for the Internal Revenue Service's position that this practice satisfied the Internal Revenue Code's accrual rules. We continue to believe that the position expressed in the revenue ruling is incorrect as a matter of law and endorses a troubling policy outcome. For the reasons outlined in that letter, we believe that regulations on the accrual rules should reverse the position taken in the revenue ruling on this issue. We include the letter as an appendix to these comments.

Our other comments on the proposed regulations are as follows:

1. The proposed regulation permits an employer in certain situations to use a "delayed-wear-away approach (described in 2), even though at the end of the wear-away period an employee will experience a period of zero benefit growth. In our view, the statute does not support this result, essentially for the reasons spelled out in the 2008 revenue ruling. We say this recognizing that there are legitimate arguments that such an approach is favorable to employees, since benefits are front-loaded and employees thus earn them earlier, even though they will have a period of zero benefit growth. There are, however, also policy arguments against this approach, including that employees will nevertheless be upset when they enter a period of zero benefit growth and that the period of zero benefit growth may cause some older employees to seek other employment or simply to leave the workforce after the original formula becomes frozen. These are policy issues that should be addressed by Congress and not by regulation.
2. The proposed regulations approve of "choice-at-retirement" in situations where an employer amends a plan to adopt a new benefit formula using a different benefit base. We agree with this result, but believe that the theory adopted by the regulation to justify it is inconsistent with the statute and prohibits employers in some cases from giving choice at retirement, even though under choice at retirement, no plan participant is made worse off and some plan participants are better off. A better rationale for the result in the proposed regulation, and a rationale that might apply to new benefit formulas that fail to meet the "different base" requirement, is to treat the two formulas as formulas from two separate plans, with each formula having an offset provision. (The offset provisions would have to be coordinated to avoid an infinite looping effect.)
3. The proposed regulation, and the 2008 revenue ruling, each indicate that the accrued benefit rules apply to the benefit at "normal retirement age." This approach bears fidelity to the statutory language, but might enable abuses, particularly in small plans, where large benefit accruals are reserved until after normal retirement age. It is our view that the Department of Treasury has regulatory authority to protect the accrual rules from abuse and we would urge the Department to amend the proposed regulations to make clear that accruals that escalate after normal retirement age are unlawful if their purpose is to evade the accrual rules of sections 411(b)(1)(A), (B) and (C).

4. The preamble to the proposed regulations indicates that the regulations do not address the issue of whether immediate wear-away violates section 411(b)(1)(H), which provides that annual benefit accrual cannot decrease on account of age. The analysis in the 2008 revenue ruling is clear that during a wear-away period, the annual benefit accrual is zero. Because the wear-away period is generally longer for older employees than it is for similarly situated younger employees, an older employee is receiving a smaller benefit accrual (zero) than a younger employee with identical service, current compensation, and compensation history. We think that the IRS should finish the analysis it raises in the preamble and indicate that immediate wear-away violates section 411(B)(1)(H) in situations where the existence or length of a wear-away period correlates with the age of otherwise similarly-situated participants.

Thank you for your consideration of these comments.

Sincerely,

A handwritten signature in black ink, appearing to read "Norman Stein". The signature is written in a cursive style with a large initial "N".

Norman Stein