August 30, 2005

Hon. Mark W. Everson  
Commissioner  
Internal Revenue Service  
Room 3000 IR  
1111 Constitution Avenue, N.W.  
Washington, DC 20224  

Re: Comments on the Suspension of Determination Letter Applications for Plans Involving “Cash Balance Conversions”

Dear Commissioner Everson:

Enclosed are comments concerning the suspension of determination letter applications for plans involving “cash balance conversions.” These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Dennis B. Drapkin  
Chair

Enclosure

cc: Eric Solomon, Acting Deputy Assistant Secretary (Tax Policy), Department of Treasury  
Donald L. Korb, Chief Counsel, Internal Revenue Service  
Nicholas J. DeNovio, Deputy Chief Counsel – Technical, Internal Revenue Service  
William Bortz, Associate Benefits Tax Counsel, Department of Treasury  
Carol D. Gold, Director, Employee Plans, Internal Revenue Service  
Nancy J. Marks, Div. Counsel/Associate Chief Counsel, Internal Revenue Service  
Martin Pippins, Manager- EP Technical Guidance & Quality Assurance, Internal Revenue Service  
W. Thomas Reeder, Attorney- Advisor, Benefits Tax Counsel, Department of Treasury
COMMENTS ON THE SUSPENSION OF DETERMINATION LETTER APPLICATIONS FOR PLANS INVOLVING “CASH BALANCE CONVERSIONS”

These comments are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these comments was exercised by David Mustone and Martha Hutzelman of the Employee Benefits Committee. These comments were reviewed by James Raborn, Chair of the Employee Benefits Committee of the Tax Section of the American Bar Association. The comments were further reviewed by the Quality Assurance Group of the Employee Benefits Committee, by T. David Cowart of the Section’s Committee on Government Submissions, and by Thomas A. Jorgensen, Council Director for the Employee Benefits Committee.

Although many of the members of the Section of Taxation who participated in preparing these comments have clients who would be affected by the federal income tax rules applicable to the subject matter addressed by these comments, or have advised clients on the application of such rules, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

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August 30, 2005
I. EXECUTIVE SUMMARY

The following comments are submitted in response to the request for comments made by the Internal Revenue Service (“Service”) in Announcement 2004-71, 2004-40 I.R.B. 569, at 570 (October 4, 2004). The comments address the on-going suspension of determination letter applications submitted for tax qualified defined benefit plans that converted the benefit accrual formula from a “final average pay” or other traditional arrangement to a “cash balance” arrangement.

To minimize the on-going uncertainty as to the continued compliance of these plans (while reserving the cash balance conversion issue), we recommend that the Service process (either now or in due course as staffing and workload needs permit) the pending suspended applications for these plans and, if the plans otherwise meet the applicable tax qualification rules, issue a “caveated” favorable determination letter which provides that the letter does not address the conversion issue.

II. BACKGROUND

Beginning in the mid-1990s, many companies maintaining plans with final average pay or other traditional defined benefit accrual formulas converted their plans to, or replaced them with, hybrid formula arrangements. The most popular of these hybrid arrangements was a “cash balance” formula under which a participant’s benefit is expressed in the form of a notional account balance. These conversions were implemented in a variety of ways and sometimes involved “wear away” formulas. The conversions have generated considerable controversy in recent years. Some have been challenged in the courts as violating various age discrimination and other requirements under the Internal Revenue Code and the Employee Retirement Income Security Act of 1974, as amended. Nevertheless, many conversions were implemented in a fair and equitable manner for older employees consistent with ADEA and have not been challenged by participants.

Starting in September of 1999, the Service has required that any plan examination or pending determination letter application involving a cash balance conversion be submitted to the National Office for technical advice as to the conversion’s impact on continued qualification. Proposed regulations addressing the age discrimination rules for conversions were issued on December 11, 2002. REG-209500-86, 67 Fed. Reg. 76123. Shortly thereafter, the Service announced in early 2003 that the technical advice cases would not be processed, but would be suspended, until regulations on this subject were finalized. See Announcement 2003-1, 2003-2 I.R.B. 281 (January 13, 2003).

In the Consolidated Appropriations Act of 2004 (Pub. L. 108-199), Congress (i) prohibited the Department of Treasury from using any funds to issue regulations on the age discrimination issues and (ii) directed that Treasury offer proposed legislation on the subject. On July 6, 2004, the Service announced that the proposed regulations on conversions would be withdrawn to provide Congress with an opportunity to consider the Administration’s legislative proposal on the subject. See Announcement 2004-57, 2004-37 I.R.B. 15 (July 6, 2004).
announcement also provided that the “suspended” technical advice cases would continue to be suspended while the conversion issues are under consideration by Congress. To date, no legislation on the subject has been adopted nor has any proposal that would address past conversions made any headway in Congress.

We understand that over 1,000 determination letter applications involving “cash balance” conversions remain under suspension, many of which are plans maintained by larger employers. The following comments are submitted in response to the request for comments made by the Service in Announcement 2004-71.

III. COMMENTS

THE SUSPENDED DETERMINATION LETTERS SHOULD BE RELEASED FROM SUSPENSION AND PROCESSED

1. **Summary.**

The requirement that “cash balance” conversions be referred to the Service’s National Office for Technical Advice has now been in effect for nearly six years. During this time, the determination letter program for the Uruguay Round Agreements Act (Pub. L. 103-465) and subsequent legislation (collectively referred to as “GUST”) has been concluded. Moreover, the determination letter program under the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”), Pub. L. 107-16, for individually designed plans will open on February 1, 2006. See Rev. Proc. 2005-66. At the time the suspensions were imposed, no one reasonably expected that the suspension would last for as long as it has or carry over indefinitely into the next determination letter program.

As a result of the suspension, the most recent determination letter that the suspended plans are likely to have is one that applies the Tax Reform Act of 1986 (“TRA’86”), Pub. L. 99-514, and subsequent legislation covered in the TRA’86 determination letter program. At the same time, there is no indication that Congress will address the “age discrimination” questions raised about past conversions.

2. **Recommendation.**

To minimize the on-going uncertainty as to the continued compliance of the suspended plans, we recommend that the IRS process (either now or in due course as staffing and workload needs permit) the pending suspended applications for these plans and, if the plans otherwise meet the applicable tax qualification rules, issue a “caveated” favorable determination letter which provides that the letter does not address the conversion issue.

3. **Explanation.**

The suspension has deprived the affected plans of an up-to-date favorable determination letter for almost six years (with no end in sight), effectively putting them in indefinite limbo. We
believe that continuing the suspension in the current environment could have a negative effect on these plans and their participants. First, the absence of an up-to-date determination letter creates unnecessary uncertainty as to the plan’s continued compliance with the qualification requirements (other than the underlying age discrimination issues) and deprives the plans (and their sponsors) of the “reliance” that a determination letter provides in maintaining and administering plans of this sort. At the same time, the absence of an up-to-date letter could make it more difficult for participants to make rollovers to other employer plans (where a determination letter is requested as proof of the transferor plan’s continued qualification).

Second, without a determination letter, a plan is unnecessarily exposing the administrator and sponsor to potentially larger liabilities and corrections for other matters. For example, to remain tax qualified, the plans must be operated in accordance with their terms; yet, despite having timely submitted the plans under the GUST determination letter program, they do not have a current letter on which the plan administrator can rely. This arguably leaves the door open for the Service to challenge a plan’s continued qualification for operating under plan provisions deemed to be defective in audit.

At the same time, the failure to issue a letter also unfairly impacts the ability of these plans to self-correct under the Employee Plans Compliance Resolution System (“EPCRS”). See Revenue Procedure 2003-44, 2003-1 C.B. 1051. Thus, in the absence of an up-to-date determination letter, it appears that the plans may not be eligible to use the special rules for correcting significant errors under the EPCRS self-correction program. See id., section 4.03, 2003-1 C.B., at 1056 (which provides that a plan must have an up-to-date determination letter to use this procedure). Moreover, the suspension also calls into question whether these plans can retroactively correct operational errors under the voluntary correction program (“VCP”) by plan amendment where a determination letter application must be filed concurrently with the VCP application. See id., section 4.06, 2003-1 C.B., at 1057. Viewed from this perspective, continued suspension could significantly undermine on-going efforts to keep these plans compliant.

Finally, the continued uncertainty as to the status of the suspended plans could ultimately lead the sponsors to abandon these programs altogether, leaving participants with no “defined benefit plan” benefits at all. With the increasing financing and other pressures coming to bear on these plans, the continued absence of a determination letter (with no end in sight) could add to plan sponsor concerns as to the continued viability of these arrangements and could ultimately tip the scales in the favor of termination.

At the same time, we believe that favorable letters can be issued for these plans now without undermining the government’s rulings suspension on the age discrimination issues. These competing considerations can be fairly accommodated by issuing a “caveated” letter for each plan which provides that the determination letter does not address these issues. Of course, any other appropriate limiting language also could be included. While it would be better to process the suspended applications before the EGTRRA determination letter program opens in 2006, we recognize that the Service’s current staffing needs and workload may require a different course of action.