

ASPPA *asap*

A publication of the ASPPA Government Affairs Committee

September 23, 2008 :: No. 08-30

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Latest Developments on EOY Valuation AFTAPs

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On September 18, 2008, IRS published a special edition of Employee Plans News (<http://www.irs.gov/pub/irs-tege/se0908.pdf>) providing transition relief for small plans with end-of-year (EOY) valuations facing an October 1 deadline for the 2008 AFTAP certification. The relief would permit EOY valuation plans to certify the 2008 AFTAP based on the December 31, 2007 valuation results “with appropriate adjustments,” as long as final calculations do not produce “materially” different results.

ASPPA and COPA worked with IRS and Treasury to develop this transition relief and appreciate the effort the agency expended in developing and publishing the relief. However, even with this relief, small plans may be unable to use an end-of-year valuation date for 2008, and would not know with certainty until after the end of the 2008 year whether or not the EOY valuation date is truly available. At the urging of ASPPA, the leadership of the House Ways and Means Committee and the Senate Finance Committee has sent a letter to Treasury Secretary Paulson urging him to issue guidance permitting plans with end of year valuation dates to use December 31, 2007 valuation results to determine final 2008 AFTAPs – that is, not contingent on December 31, 2008 results. The letter makes it clear that the writers believe such guidance would be implementing Congressional intent.

▲ Background

The Pension Protection Act of 2006 (PPA) created IRC §436, providing that certain payment and benefit restrictions apply if a defined benefit pension plan’s adjusted funding target attainment percentage (AFTAP) is less than 80%, and no additional benefits can be accrued if the AFTAP falls below 60%. The AFTAP for a plan year is the ratio of the plan’s assets (reduced by credit balances) to the plan’s funding target, adjusted for annuity purchases for non-highly compensated employees over the past two years. In determining the AFTAP, both assets and liabilities are determined as of the plan’s valuation date. Under PPA, most

plans must use the first day of the plan year as the valuation date. However, PPA permits plans with less than 100 participants to use a valuation date of the last day of the year, and thousands of small plans use EOY valuation dates.

Under PPA, a plan’s AFTAP for the year must be certified by October 1 of the year. IRC §436 is first effective for 2008, so October 1, 2008 is the first deadline for a final AFTAP certification. Read literally, PPA would require small plans with EOY valuations to determine an AFTAP based on December 31, 2008 results by October 1, 2008 – an impossible situation. ASPPA has consistently argued that the clear intention of the law is to determine the 2008 AFTAP for EOY plans based on the December 31, 2007 results. All versions of technical corrections that have passed the House and Senate include language providing the Secretary of the Treasury the authority to write the special rules.

Earlier this year, IRS issued two notices regarding AFTAP determination for EOY valuation:

- **Notice 2008-21** provided that a calendar year plan with an EOY valuation date could base its 2007 AFTAP (upon which restrictions could be presumed before October 1, 2008) on valuation results for December 31, 2006. To take advantage of this relief, the plan must have an EOY valuation date for 2006, 2007 and 2008. IRS said it would issue similar rules for 2008 (permitting the use of December 31, 2007 valuation results to determine the 2008 AFTAP) if it had authority to do so.
- **Notice 2008-73** simply removed the requirement that a plan have an EOY valuation date for 2008 in order to base the 2007 AFTAP on December 31, 2006 results. In other words, the plan could base its 2007 AFTAP on December 31, 2006 results even if the plan changed to a beginning-of-year (BOY) valuation for 2008. The IRS stated that it is considering

Continued on next page

guidance that would allow plans using the Notice 2008-73 relief to change back to an EOY valuation for 2009; but did not comment on whether or not a change back to EOY valuation would be permitted for 2008, once technical corrections are passed.

Based on the guidance provided in these Notices, a plan would not be able to maintain an EOY valuation date without running afoul of the IRC §436 restrictions on October 1, 2008. (See ASAP No. 08-27 for more information on Notices 2008-21 and 2008-73.)

▲ Transition Relief for 2008

In the September 18, 2008, special edition of Employee Plans News, IRS provided transition relief for EOY valuation plans with regard to the AFTAP certification due October 1, 2008. The relief resulted from extensive discussions ASPPA and COPA representatives had with IRS and Treasury about the impossible task facing EOY valuation plans. The transition relief provides that for 2008, the Service will not challenge an actuary's certification of a 2008 AFTAP for a plan with an EOY valuation date based on a date other than the 2008 valuation date *provided the AFTAP is subsequently certified on the actual valuation date and the final certification is not materially different¹ from the estimate*. The relief goes on to provide that the AFTAP has to be based on a 2008 valuation date, but December 31, 2007 results "with appropriate adjustments" can be used to estimate a BOY 2008 AFTAP, again provided that the AFTAP is subsequently certified on the actual valuation date and the final certification is not materially different from the estimate. The relief does not describe an appropriate adjustment, but factors to consider would presumably include the change in mortality and interest assumptions, 415 increases, and the liability arising from the addition of any new participants if past service credit is provided. The relief does not mandate a non-zero adjustment, just an "appropriate" adjustment.

The relief does not assure that a plan can use an EOY valuation date for 2008. The relief does provide a clear path for a well-funded plan to avoid the imposition of benefit restrictions due to failure to certify a 2008 AFTAP by October 1, 2008. For example, consider a plan with an AFTAP of over 100% based on the December 31, 2007 valuation results.

¹ Proposed regulation 1.436-1(h)(2) provides that a change is "material" if the plan operation would have been different based on the subsequently determined AFTAP. 1.436-1(h)(3)(c) points out that if there is a material change, the plan will have either failed to satisfy IRC §401(a)(29) and 436, or failed to follow the terms of the plan.

The actuary may certify the 2008 AFTAP by October 1, 2008 by adjusting the 2007 results for anticipated increases on January 1, 2008. Barring special circumstances, such as past service credit for new participants, the estimated AFTAP will not be less than 95%. It is likely, but not certain, the results of the December 31, 2008 valuation will not produce an AFTAP that is less than 80%, so the plan will be able to continue to use the EOY valuation date. However, assuming an appropriate adjustment for the BOY estimate, the plan sponsor can be assured that even if there is a material change in the December 31, 2008 results, the plan can switch to a January 1 valuation date for 2008 to avoid the material change in AFTAP, and comply with IRC §436.

Some actuaries have already certified 2008 AFTAPs based on December 31, 2007 results, assuming the intentions stated in Notice 2008-21 will ultimately be reflected in regulations. This transition rule would appear to provide support for the position that an "appropriate adjustment" is zero, and that the certification meets the requirements outlined in this transition relief, provided the December 31, 2008 results are not materially different.

▲ Limitations of the Relief

Although the relief will enable many well-funded plans to continue with EOY valuation dates, even well-funded plans will not know with certainty until after the December 31, 2008 valuation is completed whether or not the plan can use the EOY valuation date. Declining market values, benefit payments or other unanticipated events can reduce the AFTAP, and force the plan to abandon the EOY valuation for 2008.

The relief also provides limited assistance to plans that are funded near the 80% (or 60%) level. The main benefit of the relief for these plans is to permit a BOY valuation for the initial AFTAP certification, then a change to an EOY valuation for 2008 if there is no material change in the resulting AFTAP - a result not specifically permitted under previous guidance.

For example, consider a plan with assets of \$810,000 and liabilities of \$1 million on December 31, 2007. Certifying an AFTAP based on December 31, 2007 results with zero adjustment (an AFTAP of 81%) would result in no benefit restrictions taking effect on October 1. However, even a modest investment loss or benefit payment could result in an AFTAP below 80% - a material change - on December 31, 2008. If an adjustment other than zero is appropriate, the amount of the "appropriate adjustment" to the December 31, 2007 results used to make a reasonable estimate of a January 1, 2008 AFTAP would be the sole determinant of whether or not restrictions apply, placing undue weight on the method of estimation. In this

scenario, operating under the terms of the relief, the actuary would probably want to run a January 1, 2008 valuation to make the initial 2008 AFTAP certification. If there is no material change in a subsequently determined December 31, 2008 AFTAP, the plan could continue with the EOY valuation date. If there is a material change in the December 31, 2008 results, the plan would adopt a BOY valuation date for the current year.

▲ Congressional Letter Regarding Intent

At the urging of ASPPA, the leadership of the House Ways and Means Committee and the Senate Finance Committee has sent a letter to Treasury Secretary Paulson urging him to issue guidance permitting plans with end of year valuation dates to use December 31, 2007 valuation results to determine final 2008 AFTAPs. The letter, signed by Chairmen Rangel and Baucus, and Ranking Members McCrery and Grassley, makes it clear that the writers believe such guidance would be implementing Congressional intent. If IRS issues the guidance contemplated by Notice 2008-21 as a result of this letter, or passage of PPA technical corrections, the 2008 AFTAP for an EOY valuation plan could be certified based on the December 31, 2007 valuation results, regardless of whether the December 31, 2008 valuation results are materially different.

We still are pushing for passage of pension technical corrections, but we are grateful to the tax committees' leadership and their staff for listening to our concerns, and asking Treasury to modify its guidance to assure small plans can continue to operate with end-of-year valuation dates as authorized by PPA.