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Consultants and Actuaries

# Multiemployer Review

SUMMER 2005

• Borrowing Contributions from the Following Year

• Correcting Amendments to the Suspension of Benefit Rules

## Extensions of the Amortization Period to Cure Funding Deficiencies

A number of jointly trustee plans are projecting a funding deficiency over the next few years. The funding shortfall is attributable mainly to the bear market of 2000-2002. In some cases, the effect of the bear market was exacerbated by benefit increases that plans were forced to adopt during the 1990s to protect the deductibility of employer contributions.

To avoid the deficiency, many of these plans will need to increase contributions substantially or cut benefits for future service. In the meantime many Boards of Trustees are seeking relief from the IRS by filing applications to extend the amortization period for existing funding bases.

In 2004, the IRS issued guidance on applying for an extension of the amortization period, but IRS staff have been unable to agree on the standards for approving these applications. During a recent enrolled actuaries conference, IRS representatives announced that they had finally agreed on a set of internal guidelines for evaluating applications and hope to issue their first decision in June.

One major sticking point for the IRS has been the difference between the short-term interest rate the statute uses for amortization extensions and the plan's valuation rate. The IRS has decided to require plans to make an adjustment so that the lower, statutory interest rate would not affect the required contributions. This decision, however, will result in a significant reduction in the amount of relief that an amortization extension will provide. For example, a plan granted a five-year extension that would experience a 40% reduction in required contributions if the statutory interest rate were used might only end up with a 10% reduction if the IRS approval requires the plan to ignore the savings produced by the statutory interest rate. The actual difference in the reduction of required contributions will vary from plan to plan, but disregarding the effect of the lower statutory interest rate will likely reduce the relief that otherwise was expected by 50% or more.

Trustees may still find having an extension of the amortization period advantageous, even after eliminating the effect of the lower statutory interest rate. In any case, the application to the IRS must be submitted before the end of the plan year for which the extension is requested. The application must contain detailed information about the plan, as well as a projection of the plan's funding status for at least 10 years following the extension period. For example, if the plan requests a five-year extension, the plan's funding status must be projected over 15 years.

To qualify for the extension, the plan must show that without the extension, it will be forced to terminate or substantially cut back benefits and that a denial of the extension will be adverse to the interests of plan participants. The plan also needs to show that its minimum funding deficiency is a short-term problem that will be eliminated and will not return during the projection period if the amortization extension is granted. A request can seek up to a 10-year extension of any or all of its charge bases, but a five-year extension has a more realistic chance of being approved. In addition to showing that the plan satisfies minimum funding requirements during the projection period if the amortization extension is granted, the plan will probably have to show that its funding ratio (assets to liabilities) actually improves over the same period. The extension request must also describe the actions already taken—such as increasing contributions or reducing future accruals—to address the funding deficiency. In addition, all employers represented on the Board of Trustees and all employers that are responsible for at least 5% of the plan contributions must supply their financial information directly to the IRS when the Trustees file an application. Employers are not required to supply any such information to the Board of Trustees and the IRS is required to keep the financial information confidential. Nonetheless, some employers will be reluctant to supply their financial information to the IRS.

The bottom line is that qualifying for an extension will be difficult and the relief provided will be less than originally expected.

## Borrowing Contributions from the Following Year

For more than 20 years, plans facing funding deficiencies have commonly applied contributions made up to eight-and-a-half months into the following plan year against the funding standard for the prior year. Recently, a plan that requested an IRS ruling on this issue received a troubling response. IRS letter ruling 200517034 stated that contributions could only be counted for a plan year if they were

made for work performed in that year. Private Letter Rulings are not binding on the IRS and have no precedential value, but they do represent the thinking of IRS staff. The American Academy of Actuaries is trying to have the IRS reconsider this position, but Trustees should be aware that borrowing contributions from the next plan year to meet the funding standards could be challenged if the plan is audited.

## Correcting Amendments to the Suspension of Benefit Rules

The IRS has issued guidance on how plans can correct changes in their "suspension of benefit" rules that violate the US Supreme Court's decision in *Central Laborers' Pension Fund v. Heinz*, which held that a plan amendment expanding the categories of post-retirement employment resulting in the suspension of early retirement benefits violates the anti-cutback rules of ERISA and the Internal Revenue Code. *Revenue Procedure 2005-23*, which is effective April 18, 2005, allows plans that changed their suspension of benefit rules to avoid disqualification by adopting and fully implementing a "reforming" amendment by January 1, 2006. The IRS guidance requires the amendment to provide the following:

- Any changes to the suspension of benefits rules must not apply to benefits that had accrued as of the later of the effective or adoption date of that change.
- The plan must make payment, retroactive to June 7, 2004, of participants' benefits that were suspended as a result of the change and that had accrued as of the effective date of the change.

- Any participant who would have been eligible to receive benefits but for the change must be given the option to retroactively commence benefits as of June 7, 2004. The plan must notify participants about this option on or before January 1, 2006, and the election period must begin within a "reasonable" period of time after the participants receive the notice and end no sooner than six months after notification.

The reforming amendment *may* provide that the terms of the change continue to apply to benefits that had accrued *after* the *applicable amendment date* of the change, and a plan may continue to apply the suspension of benefit provisions that were in effect prior to the change to all accrued benefits.

Plans that changed their suspension of benefit rules cannot continue to rely on a previously issued favorable determination letter from the IRS and must reapply for a determination letter that the plan is qualified. The IRS also notes that its revenue ruling does not affect a participant's rights under ERISA or any other law, which leaves plans subject to lawsuits by participants.

**Multiemployer Review: Update on Issues Affecting Taft-Hartley Plans** is intended to provide information and analysis of a general nature. Application to specific circumstances should rely on separate professional guidance.

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page 2

