AMERICAN BENEFITS COUNCIL

September 8, 2009

Via Electronic Delivery

J. Mark Iwry
Deputy Assistant Secretary for Tax Policy- Retirement and Health Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW, Room 3064 MT
Washington, DC 20220

**Re: Effect of Potential Decline in CPI-U on the 2010 Retirement Plan Limits**

Dear Mark:

The American Benefits Council (Council) is submitting this letter in connection with the forthcoming announcement of the retirement plan limitations for 2010. The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

As you know, various dollar limits with respect to retirement plans are adjusted annually based on the Consumer Price Index for July, August, and September (the Third Quarter CPI-U). The affected provisions include, among others, Code sections 401(a)(17), 402(g), 408(k), 408(p), 409, 414(q), 415(b), and 415(c) (collectively, the Limits). It is possible that the 2009 Third Quarter CPI-U will fall from 2008 levels, and we understand that the Internal Revenue Service is actively considering whether all or some of the 2010 Limits will be less than the 2009 Limits in the event of such a decline. As discussed in detail below, the Council strongly believes that a decline in the Limits would send the wrong message about the importance of retirement saving and that the law is best interpreted to preclude a year-over-year decline in the Limits.

**Decreasing the Limits Would Discourage Saving for Retirement**

The Council firmly believes that a fall in the Limits is not in the best interests of our retirement system. The amounts that employees may contribute to voluntary savings plans should not be reduced in the aftermath of the economic downturn. Many employees are in the midst of rebuilding their retirement savings after the unprecedented fall in the capital markets during 2008. A decline, for example, in the Code section 402(g) limit on elective deferrals would make it harder for employees to make up for last year's steep investment losses at the very time at which we should be making it easier for employees to save.

Moreover, it would be a mistake to assume that only very highly paid individuals will be affected by a fall in the limits. The need to rebuild retirement savings makes it more likely that rank-and-file employees, particularly near-retirees, will run into the Code section 402(g) limit. Others would be limited by the actual deferral percentage test in the amount they may save if the threshold for highly compensated employees under Code section 414(q) falls, particularly individuals who would otherwise be on the high end of the non-highly compensated employee scale under Code section 414(q).

A year-over-year decline in the Limits could also have an impact on the retirement savings of employees who are not directly affected by any of the Limits. A fall in the Limits would garner national press attention and would be widely publicized. For many working Americans, it would signal that there is less of a need to save. Employees need to be saving more, not less, and such a message could have adverse consequences for retirement savings.

The impact of a year-over-year decline in the Limits would also not be limited solely to employment-based retirement plans. The normative message associated with a decline in the Limits could affect other savings. Further, a reduction in the amount of tax-deferred money that can be saved through an employer-sponsored retirement plan would also result in greater taxable income for all individuals who would otherwise save more, and could ultimately decrease an individual's ability to qualify for a deductible IRA contribution.

**The Statutory Language and Intent Prohibits a Decrease in the Limits**

In addition to representing sound public policy, the Council also believes that the better reading of the applicable authority is that a year-over-year decline in the Limits is not permitted. The annual adjustment in the contribution and benefit limits under Code section 415 is determined by application of Code section 415(d). The adjustments in the other Limits are determined by reference to the mechanisms under Code section 415(d). The language of Code section 415(d) on its face contemplates only upward adjustments to the Limits, stating that "[t]he Secretary shall adjust *annually* [the Code section 415(b) and 415(c) limitations] for *increases* in the cost-of-living in accordance with regulations" (emphasis added). The use of the word "increase" throughout Code section 415(d) plainly suggests that Congress intended that adjustments based on the Third Quarter CPI-U operate only to increase the Limits from year to year. The statutory language reflects that the Limits must annually increase or remain unchanged; annual downward adjustments are not permitted even if the cumulative adjustment in the cost-of-living from July 1, 2001 through the present time is less than the cumulative change in the Limits since such date.[1]

**Congress Directed Treasury to Establish Adjustment Procedures Similar to Social Security Adjustment Procedures, Which Do Not Permit a Decrease**

The Council also believes that the Limits may not be reduced because Code section 415(d) requires that the Limits be determined in a manner "similar to the procedures used to adjust benefit amounts under . . . the Social Security Act."[2] This language does not merely dictate the mathematical methodology used to adjust benefits. Social Security benefit adjustment procedures cannot result in a benefit decrease from year to year. Section 215(i) of the Social Security Act[3] provides the Social Security benefit adjustment procedures and indicates that the Social Security benefit is only adjusted in the event of an *increase* in the relevant indices. The Social Security Handbook emphasizes this point, stating that "[i]n no event does a cost of living adjustment decrease the total amount of benefits payable on your earnings record."[4] Similarly, the taxable wage base for FICA taxes is adjusted annually but cannot decline.[5] Accordingly, similar procedures under Code section 415(d) would dictate that the Limits cannot be adjusted downward.

**Determining the Adjustment by Reference to July 1, 2001 Is Intended to Ensure that the Passage of Time Does Not Distort the Limits**

The only possible basis we are aware of for concluding that the Limits may be decreased is the mathematical formula set forth in Code section 415(d) and the regulations thereunder, which establish the mechanism for cost-of-living adjustments. The mathematical formula determines the cost-of-living adjustment based on the cumulative cost-of-living increase since July 1, 2001

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[1] The legislative history of Code section 415(d) further supports the Council's view that Congress did not intend that the Limits decrease from year to year. *See, e.g.*, H. Rep. No. 107-84, at 211 (2001) (Conf. Rep.) (stating that defined benefit plan limitations are "adjusted for cost-of-living *increases*" (emphasis added)); H. Rep. No. 99-841, at II-475 (1986) (Conf. Rep.) (stating that the method of indexing the dollar limits is "by reference to *increases* in the consumer price index" (emphasis added)); H. Rep. No. 97-760, at 617 (1982) (Conf. Rep.) (stating that the limits are "automatically adjusted for cost-of-living *increases*" (emphasis added)); H. Rep. No. 93-1280, at 343-44 (1974) (Conf. Rep.) (stating that the defined benefit limits "are to be adjusted to reflect cost-of-living *increases*" and defined contribution limits are "subject to an annual cost-of-living *increase*" (emphasis added)).

[2] I.R.C. § 415(d)(2)(B).

[3] 42 U.S.C. § 415(i).

[4] SOCIAL SECURITY ADMINISTRATION, SOCIAL SECURITY HANDBOOK, § 504.8 (2009), http://www.ssa.gov/OP_Home/handbook/download.html. *See also* 42 U.S.C. § 415(i) (stating that, in the event a specified cost-of-living index increases during the third quarter of a year, "the Commissioner shall . . . *increase* . . . the benefit amount to which individuals are entitled . . . under [42 U.S.C. 427]" (emphasis added)).

[5] *See* 42 U.S.C. § 430(b) (stating that "[t]he amount of [the] contribution and benefit base shall . . . be the amount of the contribution and benefit base in effect in the year in which the determination is made or, *if larger*," the product of certain amounts (emphasis added)).

and not from the most recent year-over-year change in the dollar limit in effect.[6] However, when the mathematical formula is understood in context, it is clear that Congress contemplated only cost-of-living increases, not cost-of-living decreases.

The fact that the formula used for determining the cost-of-living adjustment to be applied in a given year is based on the change in the cost-of-living since July 1, 2001 is meant to ensure that the Limits are not distorted by either the rounding mechanism in Code section 415(d) or the passage of time. If, for example, the cost-of-living adjustment was determined based on the rounded limit in effect for a year, then over time the Limits would very likely drift from changes in the cost-of-living. The formula's comparison to the 2001 CPI-U can thus be reasonably read as avoiding possible distortions in the cost-of-living increases.

**Defined Benefit Plans May Encounter Anti-Cutback Issues**

The Council is also concerned about the impact of a decline in the Limits on the retirement benefits of participants, particularly early retirees, such as public safety officers, who most commonly run into the Code section 415(b) limits on benefits payable from a defined benefit plan. A decline in the Limits could, for example, mean that current retirees would have their annuity payments reduced or that near-retirees would see their accrued benefits suddenly fall. This alone suggests that a year-over-year decline in the Limits should not be possible.

There is no guidance on how a regulatory decrease in the Limits would interact with the anti-cutback rules under Code section 411(d)(6). Treasury could construe the anti-cutback rule to protect previously accrued benefits.[7]
This would, of course, create administrative burdens, although this would be a plan-by-plan issue, and the Council is not aware of any guidance that addresses this issue. It would be particularly challenging for multiple employer defined benefit plans and for administrators that provide compliance services to numerous defined benefit plans. In any event, however, the Council believes that it is critical that Treasury provide guidance on these complicated issues if it interprets the Limits in a manner that permits a year-over-year decline in the Limits. Plan

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[6] *See* Treas. Reg. § 1.415(d)-1(a)(1). *See also* METHODOLOGY FOR CALCULATING COST-OF-LIVING INCREASES UNDER § 415(d) OF THE INTERNAL REVENUE CODE (2009) (IRS white paper applying the mathematical formula in a series of examples).

[7] Code section 411(d)(6) prohibits a decrease in accrued benefits via plan amendment. In this context, the extent to which the anti-cutback rule preserves current benefits depends on whether a change in the Code section 415 limit in connection with a cost-of-living adjustment is a plan amendment. We understand that the IRS has in the past informally suggested that a cost-of-living increase in the Code section 415(b) limit is a plan amendment for certain purposes, including minimum funding and benefit restriction purposes. This reading, however, is somewhat anomalous in the context of Code section 411(d)(6), at least in plans that incorporate the limit by reference so that there would literally be no plan amendment. Moreover, it is not hard to conclude that there may be different answers for different regulatory purposes. Apart from the amendment question, we also note that one can easily conceptualize the Code section 415 limit as an inherent part of the accrued benefit, which would suggest that a reduction in the limit would not be governed by the anti-cutback rule.

sponsors, administrators, and participants should be made aware of how such issues are to be handled so that retirees are not recipients of unexpected and inappropriate benefit "haircuts."

**A Decrease in the Limits Would Lead to Qualification and Administrative Issues**

If Treasury were to reduce the Limits, it could also create inadvertent qualification errors and administrative headaches. There are different approaches to describing the Limits in plan documents, ranging from ones that closely hew to the approach in the list of required modifications (LRMs), which uses the "increase" language from the statute, to more individually designed language. It is likely, however, that some plan sponsors would need to amend their plans or else they would inadvertently run afoul of the operational requirements of their plans (and the Code section 415 limits) if the Limits are decreased. Others would feel obligated to amend their plans, even if the plan simply repeated the statutory language in section 415(d), because that language uses the term "increase" and does not appear to contemplate a year-over-year drop in the Limits. It is not fair to place this unnecessary risk, expense, and administrative burden on plan sponsors. In addition, many plan sponsors have described the Code section 415 cost-of-living adjustment in participant communications in terms of an increase. As a result, many participants are under the impression that a cost-of-living adjustment can only result in an increase in Limits, not a decrease. Thus, new communications materials would need to be provided, and it is likely that some employees would be confused by the change.

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The Council greatly appreciates your consideration of our concerns. If you have any questions, please do not hesitate to contact Jan Jacobson, the Council's senior counsel, retirement policy, at 202-289-6700.

Sincerely,

Jan Jacobson
Senior Counsel, Retirement Policy
American Benefits Council