AMERICAN BENEFITS COUNCIL

September 3, 2010

TECHNICAL CORRECTIONS AND GUIDANCE NEEDED: 2010 FUNDING RELIEF LEGISLATION

This document sets forth technical corrections and guidance that are needed with respect to the funding relief contained in the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010. Some issues may be addressed by either a technical correction or administrative guidance, though we recommend the certainty of a technical correction. Those issues are identified with an asterisk.

TECHNICAL CORRECTIONS IN SENATOR BAUCUS' AMENDMENT

We support the technical corrections set forth in Senator Baucus' amendment to the Small Business Jobs Act (H.R. 5297). Specifically:

Section 301: We support permitting an employer to elect funding relief with respect to a year if the due date for contributions for such year is on or after March 10, 2010 (rather than on or after the date of enactment (June 25, 2010)). This would permit relief with respect to, for example, plan years beginning 9/1/08 or 10/1/08.

Section 302: We support the revised definition of an "eligible charity plan" contained in the amendment. It is critical that such definition include a provision treating a plan as an eligible charity plan only if the plan sponsor elects for the plan to be so treated. So we support section 102. However, we believe a different technical correction would produce a more appropriate result. That technical correction, with an accompanying explanation, is attached as Attachment A.

Section 303/benefit accruals. Under section 303, very generally, if a plan was at least 60% funded for 2008, it need not be frozen for the 2009-2011 years (as opposed to the 2009-2010 years). We support conforming this relief to the funding relief so that both extend through 2011.

Section 303/social security leveling options. It is critical that the relief with respect to social security leveling options be prospective only, as set forth in section 303. If this relief is not provided, many other issues would need to be addressed.

OTHER TECHNICAL CORRECTIONS NEEDED

Excess Employee Compensation.

- **Former employees.** It should be clarified that amounts paid to former employees are not taken into account in determining the aggregate amount of excess employee compensation*. If the term "employee" included former employees, there would have been no reason for the parenthetical in ERISA section 303(c)(7)(D)(i)(I) and Code section 430(c)(7)(D)(i)(I): "(whether or not performed during such calendar year)".
- **Nonresident aliens.** It should be clarified that amounts paid to—or set aside on behalf of—nonresident aliens are not taken into account in determining the aggregate amount of excess employee compensation.* Nonresident aliens are generally in separate profit centers and subject to wholly different pay scales and considerations. It would not be appropriate to subject their pay—or any amounts set aside for them under a nonqualified deferred compensation plan—to this rule.
- **Restricted stock.** It should be clarified that the reference in the binding written contract exception to "restricted stock" also includes "restricted stock units".*

EBITDA.

- **Losses.** Assume that a company operates at a loss for a year, so that its EBITDA is a loss of $10 million. Assume further that the company redeems $1 million of shares. It should be clarified that the extraordinary redemption is $1 million, not $11 million.* Otherwise, a bizarre cliff is created whereby a $1 payment can trigger millions of dollars of contributions.
- **Fiscal year.** The law measures EBITDA based on the preceding plan year. Since EBITDA is only calculated on a fiscal year basis, it should be clarified that EBITDA should be determined based on the fiscal year ending with or within the preceding plan year.*

* This issue could also be addressed through administrative guidance, but a technical correction is recommended.

Historical Dividend Rule.

- **Smaller dividend.** If a plan sponsor determined and declared a dividend in the same manner for at least the preceding five years, the historical dividend rule applies if the same dividend is declared in the current year. It should be clarified that if instead the company declares a smaller dividend in the current year, the historical dividend rule would also apply.*

Preferred Stock Rule.

- **Replacement stock.** It should be clarified that the preferred stock rule applies not only to stock issued before March 1, 2010 but also to stock issued to replace such stock.* Corporate restructurings that have no effects on funding-related issues should not affect funding relief.

Double Counting Issue.

It is our understanding that some are taking the following position ("Double Counting Position"). Assume that a plan sponsor elects the 2 and 7 rule for the 2010 and 2011 plan years. Assume further that the plan sponsor pays an extraordinary dividend of $1 million in 2012. The Double Counting Position is that, since that $1 million is paid within the restriction period for both 2010 and 2011, the $1 million is double counted so that the company must contribute $2 million. (The Double Counting Position applies equally to excess employee compensation and extraordinary dividends.)

This position is wrong. First, since the cash flow rule was intended to create matching contributions with respect to specified payments, it is inappropriate to double count the same payments. Second, if the Double Counting Position were correct, it would create bizarre results. Under ERISA section 303(c)(7)(F)(iii) and Code section 430(c)(7)(F)(iii), it is clear that if a plan sponsor elects funding relief for two different plans for the same year, there is no double counting. Similarly, it is also clear under the same provision that if a plan sponsor elects funding relief for Plan A for 2010 and for Plan B for 2011, there is no double counting. That makes it extremely strange to conclude that there is double counting if a plan sponsor instead elects funding relief for Plan A (or Plan B) for both years.

Applying the Double Counting Position leads to even stranger and more unworkable results. Assume that a plan sponsor elects funding relief for Plan A for 2010 and for Plans A and B for 2011. Assume further that each plan's reduction in its shortfall amortization installment for the first plan year in the amortization period is the

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same. Then the plan sponsor pays a $3 million extraordinary dividend in 2012. How much does the plan sponsor owe in additional contributions? Under ERISA section 430(c)(7)(F)(iii) and Code section 430(c)(7)(F)(iii), the $3 million total must be allocated, so that an additional contribution of $1 million is owed to each plan. That is clear. Yet the Double Counting Position relies on a different provision to double count the $3 million with respect to Plan A. If that result occurs, which technically it should not, then there is a conflict under the statute because there is no way to apply both the Double Counting Position and the cited provisions. Under one possible interpretation—which is not technically perfect—zero is owed to Plan B, since ERISA section 303(c)(7)(F)(iii) and Code section 303(c)(7)(F)(iii) require the total $3 million—and no more—to be allocated among Plans A and B. That result makes no sense, but these types of anomalies are created by the Double Counting Position.

This issue needs the certainty and clarity of a legislative resolution.

Mergers and Acquisitions.

It is critical that Treasury and IRS promptly exercise its authority to prescribe rules to address the application of the cash flow rule in the case of mergers and acquisitions. If this does not occur, Congress needs to act. These issues can have material effects on corporate transactions.

Assume that Company A elects 2 and 7 funding relief for 2011. Company B does not elect funding relief. As of October 1, 2013, B acquires A.

- Assume further that prior to October 1, 2013, B paid numerous amounts that would have triggered the cash flow rule. Since B had no relationship to A's plan prior to October 1, 2013, no such payments should trigger the cash flow rule.*
- Any amounts paid by the merged company on or after October 1, 2013 should be disregarded for purposes of the cash flow rule if they are paid pursuant to a binding written commitment made by B prior to the merger (unless paid to A employees).* To penalize B for commitments made prior to the merger has no deterrent effect; it is simply punitive.
- Payments by B for A stock pursuant to the transaction should not be treated as redemptions or dividends, even if paid in installments after the closing of the acquisition.*
- Nonqualified deferred compensation, restricted stock, restricted stock units, stock options, and stock appreciation rights paid by A or B on account of the acquisition by B pursuant to a binding written commitment in effect on March 1, 2010 should be covered by the binding written commitment provision and by the

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exclusion of compensation attributable to services rendered before March 1, 2010.*

- In determining EBITDA, A and B's EBITDA should be added together.*

GUIDANCE ISSUES

Excess Employee Compensation.

- **Allocation of pay to time periods.** In the case of certain compensation—such as bonuses—the time period to which the compensation relates may not be clear, i.e., whether the compensation relates to pre-3/1/10 service. Guidance should clarify that any reasonable allocation of compensation to time periods should be permitted. In addition, safe harbor allocation methods—including ratable allocations based on days, weeks, or months—should be permitted. For example, if an employee receives a $12,000 bonus for 2010, the employer should be permitted to treat 2/12 of that bonus—i.e., $20,000—as attributable to January and February of 2010.
- **Set asides.** It should be clarified that amounts set aside under a nonqualified deferred compensation plan are only taken into account if they are attributable to services rendered after February 28, 2010. Also, guidance is needed regarding how to allocate amounts set aside under a defined benefit nonqualified deferred compensation plan to particular employees.
- **Binding contract.** Nonqualified deferred compensation, restricted stock, stock options, or stock appreciation rights paid under a written binding contract in effect on March 1, 2010 are not taken into account, as long as the contract "was not modified in any material respect before such remuneration is paid." This needs to be clarified in two respects. First, of course, modifications occurring on or before March 1, 2010 should not affect the applicability of the binding contract exception. Second, modifications with respect to one type of compensation—whether or not it is one of the four types listed—should not affect the applicability of the binding contract exception to any other type of compensation.

Dividends.

- **Same manner.** Dividends may be determined in different ways; e.g., cents per share or formulas based on various factors. Accordingly, guidance should permit any "manner" to be used for purposes of the historical dividend rule as long as it was consistently followed for at least the preceding five years.
- **S corporations.** Clarification would be helpful with respect to the application of the extraordinary dividend rule to S corporations.

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Notices and Elections.

Guidance is needed regarding how and when to elect funding relief and how and when to provide notice of the election to participants, beneficiaries, and the PBGC.

Revocation of Elections to Use or Reduce Credit Balances.

A plan sponsor may well have used its credit balance to satisfy a minimum required contribution obligation that has now been reduced by the funding relief. In addition a plan sponsor may have voluntary or mandatorily reduced their credit balances to avoid the application of the benefit accrual restriction. A plan sponsor should be permitted to elect to revoke any such usage or reduction of its credit balance. (Such revocations should be permitted at any time up to the later of (1) the due date (with extensions) of the first Form 5500 filed after the date of enactment, or (2) the date that is six months after the date of enactment.) It would be clearly contrary to Congressional intent for the credit balance rules to deny access to the relief that Congress clearly provided.

2 and 7 Calculations.

Under the 2 and 7 rule, interest on the shortfall amortization base must be paid for the first two years of the amortization period. In the case of a plan with a valuation date on the first day of the plan year, clearly no interest has accrued as of the valuation date. So the contribution as of the valuation date should equal the interest accrued as of the end of the year, discounted back to the valuation date at the effective interest rate. Any other methodology would effectively require a contribution of principal with respect to the shortfall amortization base, which was clearly not what Congress intended.

Full Yield Curve.

The 2 and 7 rule and the 15-year rule refer to use of the segment rates, just as in the Pension Protection Act ("PPA") language. It should be confirmed that, under Code section 430(h)(2)(D)(ii) and ERISA section 303(h) (2)(D)(ii), plan sponsors have the option to use the full yield curve in lieu of the segment rates for purposes of the 2 and 7 rule and the 15-year rule.

Attachment A: Eligible Charity Plans

As we understand it, the "eligible charity plan" provision in the funding bill is raising at least four concerns within the government. First, there is concern that the provision is too broad and will delay the application of the Pension Protection Act ("PPA") funding rules to many entities unintentionally. For example, many tax-exempt hospitals or universities may have tax-exempt affiliates participating in their defined benefit plan; such plans would generally be eligible charity plans under the law. It is our understanding that the government did not intend to delay the PPA funding rules for this broad a group.

Second, the same breadth of the provision is causing problems for the private sector. Many hospital or university plans described above were not aware of this provision and do not want it to apply to them, especially retroactively (as is the case). And it will not be easy for consulting firms to even identify all the plans that are covered by the provision, since the consulting firms may not know that an affiliated organization has adopted the plan. Since the provision is mandatory, a large number of plans could be inadvertently forced to retroactively shift from the PPA rules to the pre-PPA rules and many other plans will not realize that they are required to do so. This issue is causing very considerable concern.

Third, it is our understanding that the provision does not cover certain plans that were intended to be covered, because they have a very small number of non-501(c)(3) organizations in their plan.

Fourth, if the provision is narrowed as in Senator Baucus' amendment, it would hurt some sympathetic charities that would like to be covered and that have "real" multiple employer plans.

Attached is a proposal that is intended to address all four issues. Here is how the proposal is structured. Under the proposal, a plan is an "eligible charity plan" if it meets either of two tests. The first test is the House bill/Baucus amendment definition of an eligible charity plan, which (1) was designed to fit the main groups asking for the provision and (2) included an opt-in provision so that it did not inadvertently pick up any entities that did not want to be shifted to the pre-PPA rules.

The second test requires the plan to be a multiple employer plan in which the only participating employers are charities. Again, this test includes an opt-in provision, so that it does not apply to entities that do not want to be shifted to the pre-PPA rules. This test will eliminate coverage of the tax-exempt hospitals and universities that do not participate in "real" multiple employer plans. The reason that some such entities are

covered by the enacted provision is that section 414(c) aggregation is disregarded in determining whether a plan is a multiple employer plan. The attached proposal does not disregard 414(c) aggregation.

We believe that this proposal solves all four problems. First, it does not cover the tax-exempt hospitals and universities that do not maintain "real" multiple employer plans. Second, it covers the main groups that asked for the provision. Third, unlike the House bill/Baucus amendment, it provides relief for the charitable "real" multiple employer plans that want the relief. Fourth, it contains opt-in provisions so that it will not apply to any plan that does not want to be shifted to the pre-PPA rules.

STATUTORY LANGUAGE:

(d) ELIGIBLE CHARITY PLAN DEFINED.—

(1) IN GENERAL.—For purposes of this section, a plan shall be treated as an eligible charity plan for a plan year if it is described in paragraph (2) or (3).

(2) CHILDREN'S CHARITIES.—A plan is described in this paragraph if—

(A) the plan is maintained by one or more employers employing employees who are accruing benefits based on service for the plan year,

(B) such employees are employed in at least 20 states,

(C) each such employee (other than a de minimis number of employees) is employed by an employer described in section 501(c)(3) of such Code and the primary exempt purpose of each such employer is to provide services with respect to children, and

(D) the plan sponsor elects (at such time and in such form and manner as shall be prescribed by the Secretary of the Treasury) to treat the plan as an eligible charity plan.

Any election under this subsection may be revoked only with the consent of the Secretary of the Treasury.

(3) MULTIPLE EMPLOYER PLANS MAINTAINED BY CHARITIES.—A plan is described in this paragraph if—

(A) the plan is maintained by more than one employer,

(B) 100 percent of the employers are described in section 501(c)(3) of such Code,

(C) the plan sponsor elects (at such time and in such form and manner as shall be prescribed by the Secretary of the Treasury) to treat the plan as an eligible charity plan.

Any election under this subsection may be revoked only with the consent of the Secretary of the Treasury.