DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

FEB 2 - 2005

OFFICE OF
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MEMORANDUM FOR JIM HOLLAND
MANAGER, EMPLOYEE PLANS TECHNICAL

FROM: Alan Tawshunsky
Assistant Chief Counsel, Employee Benefits

SUBJECT: Issues in Section 412(e) requests – Multiemployer Plans

Background

In your memorandum forwarded to our office on November 4, 2004, you requested our opinion as to whether certain conditions could be imposed when approving a section 412(e) request.

Section 412(e) of the Code provides that the Secretary of Labor may extend the amortization period of certain funding standard account amortization bases. The authority to approve such an extension was delegated to the Secretary of Treasury pursuant to Reorganization Plan No. 4 of 1978, 1971-1 C.B. 480. Under section 412(e) of the Code, such an extension may be approved if (1) such extension would carry out the purposes of the Employee Retirement Income Security Act of 1974, P.L. 93-406 ("ERISA") and would provide adequate protection for participants under the plan, and (2) if failure to permit the extension would result in either a substantial risk to the voluntary continuation of the plan or a substantial curtailment of pension benefit levels or employee compensation, and in either case, such failure to grant the extension would be adverse to the interests of plan participants in the aggregate. In the case of a multiemployer plan, the interest rate applicable for a granted extension is the rate determined under section 6621(b) of the Code.

Your memorandum demonstrates that the requirement to use the section 6621(b) rate results in the potential for permanent underfunding of the plan if the section 6621(b) rate is lower than the plan's valuation rate. Your memorandum requested our opinion as to whether Employee Plans could condition the approval of a section 412(e) request on a plan taking steps to avoid the permanent underfunding that would otherwise result when the section 6621(b) rate is lower than the plan's valuation rate.

Discussion

We believe that Employee Plans may condition the approval of a section 412(e) request on a plan taking steps to avoid the permanent underfunding that would otherwise result when the section 6621(b) rate is lower than the plan's valuation rate.

Section 412(e) of the Code was enacted as part of ERISA. The legislative history of section 412(e) indicates that Congress expressly intended that the granting of an extension request could be made subject to reasonable conditions:

> In addition, reasonable conditions may be applied to extensions of amortization periods. For example, if an extension is allowed for amortizing liabilities a corresponding extension might be appropriate for amortizing corresponding experience gains, or amendments that decrease plan liabilities.

H. R. Rep. No. 93-807, at 83 (1974), 1974-3 C.B. Supp. 236, 318. Note that Congress intended that similar conditions could be applied when approving a section 412(d) minimum funding waiver. H. R. Rep. 93-807, at 82 (1974), 1974-3 C.B. Supp. 236, 317 ("It is also contemplated that the Service may apply reasonable conditions to a waiver, and, for example, as a condition of waiver the Service may require plan amendments that eliminate previous recent increases in liabilities.").

The Comprehensive Omnibus Budget Reconciliation Act of 1986, P.L. 99-272 ("COBRA '86), amended section 412(f) of the Code to expressly permit a section 412(e) extension or section 412(d) waiver to be conditioned on the plan sponsor's posting of adequate security. In making this amendment, Congress did not intend to restrict the ability of the Internal Revenue Service to impose reasonable conditions in connection with the approval of a section 412(d) waiver or section 412(e) extension request:

> Under current law, the Internal Revenue Service (IRS) may impose various conditions on the granting of funding waivers. However, the IRS has been reluctant to condition the granting of waivers on the providing of security to the plan for the waived amounts because of concern that this might be considered a prohibited transaction. The bill clarifies that, under certain circumstances indicating substantial risk of loss to participants and the PBGC insurance fund, the IRS may require that security be provided to a single-employer plan as a condition for the granting of a funding waiver or extension of amortization period, and that providing such security does not constitute a prohibited transaction.

H. R. Rep. No. 99-241, Part 2, at 34, *reprinted in* 1986 U.S.C.C.A.N. 685, 692.

COBRA '86 also amended section 412(e) of the Code to mandate the use of the section 6621(b) interest rate. Section 11015(b) of P.L. 99-272. However, the purpose of the mandated section 6621(b) rate was to avoid any advantage to a plan sponsor on account of the plan's valuation rate being lower than interest rates that would be charged to the plan sponsor by an unrelated third party:

> Another important problem under current law relates to waivers of the minimum funding standards and extensions of amortization periods under those standards. While the Committee recognizes that in many situations waivers and extensions may be an appropriate means of ameliorating business hardship, many plan sponsors have used the waiver process as a means of obtaining credit from a captive "lender", the plan they control. Since the waived amounts need only be repaid at the plan's interest rate, ordinarily far less than commercial lending rates, the plan is used as a bank of first resort, to the detriment of plan participants and beneficiaries, who have relied on contributions being made to fund their promised benefits.

H. R. Rep. No. 99-241, Part 2, at 33, *reprinted in* 1986 U.S.C.C.A.N. 685, 691.

The use of the ERISA grant of authority to impose reasonable conditions on a section 412(e) extension request (such as conditions that ameliorate any permanent underfunding that results from the use of the section 6621(b) rate) is not inconsistent with the requirement to use the section 6621(b) rate given Congress' reason for mandating the use of such rate.