



# IRS Backloading Guidance Under Revenue Ruling 2008-7 -- Good and Not-So-Good News for Plan Sponsors

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On February 1, the IRS issued Revenue Ruling 2008-7, applying the backloading regulations to plans with "wearaway" transitions, and to benefits based on the "greater of" multiple ongoing formulas. For plan sponsors, the ruling is a mixed bag of good and bad news.

## THE GOOD NEWS

- *Wearaway of a frozen benefit formula is not backloaded.* The case law has uniformly held that wearaway transitions are not backloaded for ERISA Title I purposes. Revenue Ruling 2008-7 now adds the same certainty for tax qualification purposes.
- *Greater-of formulas generally get administrative relief through 2008.*

Some plans base benefits on the "greater of" two or more ongoing formulas. Unlike wearaway of a frozen formula, an ongoing greater-of formula might be impermissibly backloaded, according to Revenue Ruling 2008-7.

But for plan years beginning before January 1, 2009, a greater-of formula is not impermissibly backloaded if each formula passes backloading when **tested separately**. This rule applies if the plan can satisfy one of three conditions: (i) it has obtained a favorable determination letter, (ii) it is within a remedial amendment period, or (iii) it has a determination letter application pending due to the IRS's moratorium.



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- *Permanent relief promised after 2008*

An accompanying news release states that proposed backloading regulations will be issued "soon." The regulation will provide that in some cases, greater-of formulas are not impermissibly backloaded. The regulation would be effective January 1, 2009, and would apply for tax and ERISA Title I purposes.

### THE NOT-SO-GOOD NEWS

- *Final regulation is not a done deal*

Until proposed regulations are issued, it remains unclear what kind of better-of formulas the IRS intends to bless under its pending backloading regulation. While the press release is very cursory, it hints that the IRS may intend to give permanent backloading relief only to better-of formulas meeting narrow design criteria.

- *Ruling gives no Title I protection*

Revenue Ruling 2008-7 states that the IRS will not enforce its interpretation of the backloading rules against certain greater-of formulas before 2009. But this administrative relief for tax purposes does not necessarily protect greater-of formulas from the IRS's substantive position for ERISA Title I purposes. Adverse implications may be minimal, however. Courts to consider this issue for Title I purposes have held that greater-of formulas are not backloaded under current IRS regulations, if each formula passes backloading when tested separately. *Wheeler v. Pension Value Plan for Employees of the Boeing Company*, 41 EBC 1801 (S.D. Ill. 2007); *Allen v. Honeywell Ret. Earnings Plan*, 382 F.Supp.2d 1139, 1160 (D. Ariz. 2005). IRS regulations apply for Title I purposes. Therefore, to the extent that the IRS's current regulation, as interpreted by the courts, provides that greater-of formulas are not backloaded, this rule is not trumped by the IRS's more limited position set forth only in a Revenue Ruling

- *Greater-of formulas include deferred wearaway transitions*

Some plans transition to a new formula by running the old and new formulas on a greater-of basis for some years before ultimately freezing the old formula. These deferred wearaways may be impermissibly backloaded, according to Revenue Ruling 2008-7. The good news is that they are covered by the ruling's administrative relief through 2008, and are apparently intended to be covered by the IRS's regulatory relief thereafter.



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- *Ruling extends beyond hybrid plans*

Revenue Ruling 2008-7 is couched in terms of a cash balance plan, but its rationale applies to any greater-of benefit formula, including one based on two or more conventional benefit formulas. For example, after a corporate acquisition, Buyer's plan may give Target's employees a benefit based on the greater of Buyer's and Target's final average pay formula benefits, at least for some period of time. Under Revenue Ruling 2008-7, this greater-of transition formula may well be backloaded. The ruling's administrative relief for years before 2009 covers the arrangement, but only if the greaterof formula has been the subject of a favorable determination letter, or one of the ruling's other amnesty conditions is met. Whether the IRS intends to bless any greater-of conventional formulas under its backloading regulation after 2008 remains to be seen.

#### **ACTION**

- Sponsors may wish to prepare for a worst-case scenario in which final regulations are not issued in time to protect their plan formulas for 2009, or do not cover their particular designs. Possible responses include testing post-2008 benefits under a fractional accrual rule, or modifying the benefit.
- Sponsors may wish to take stock of all their existing defined benefit plans to see if greater-of formulas arise in unexpected contexts for example, during transition periods following the acquisition of another company.