

## IRS Proposes Age Discrimination Rules

On December 11, 2002, the IRS published proposed rules regarding *age discrimination* in qualified plans. The proposal is a follow-up to the IRS' 1988 proposed rules, which have never been finalized.

Like the 1988 rules, these new rules apply to *all types* of qualified defined benefit and defined contribution plans. In addition, they specifically address the application of these rules to cash balance plans. Most importantly, they convey the message that cash balance plans are not inherently age discriminatory.

The IRS has stated the new rules, as proposed, will be effective only for plan years beginning after the date they are adopted. In the meantime, plan sponsors may continue to rely on the 1988 age discrimination proposals.

### General Age Discrimination Rules

A defined benefit plan is considered to be age discriminatory if a participant's rate of benefit accrual decreases or stops based solely on the participant's age. Likewise, a defined contribution plan is considered age discriminatory if the rate of allocation to a participant's account decreases or stops based solely on the participant's age.

This concept is not new. However, the new proposed rules now define "rate of accrual" and provide additional guidance through several examples. For defined benefit plans, two methods for determining rate of benefit accrual are provided: (1) the general rule, and (2) the rule for "eligible cash balance plans."

### Proposed Special Rules for Cash Balance Plans

Certain cash balance plans may be treated like defined contribution plans for age discrimination testing. These plans are referred to as "eligible cash balance plans." Cash balance plans that are not "eligible cash balance plans" must use the general rule for age discrimination testing.

### Outstanding Issues and Next Steps

Industry groups have identified a number of issues that are not addressed in these proposed rules. Some issues are:

- The "whipsaw" effect. Whipsaw occurs when the lump sum payment value of a participant's cash balance plan benefit exceeds the value of his hypothetical account balance.
- Application of the proposed rules to existing cash balance plans and other hybrid plans, such as pension equity plans.

\*Republished December 2004 to reflect Prudential Financial's acquisition of CIGNA's retirement business.

- Application of the proposed rules to certain traditional defined benefit plan designs that were not previously considered age discriminatory, but now appear to be discriminatory.

Industry groups are currently preparing comments to be submitted to the IRS. Their initial reaction is that these proposed rules may provide only limited guidance for cash balance plans and potentially detrimental results for certain traditional defined benefit plan designs.

The IRS is accepting comments through March 13, 2003. They have scheduled a public hearing on April 9, 2003. If you have cash balance plan design issues that require immediate attention, you should contact the plan's enrolled actuary for assistance.

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