GAO
Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

B-284580

March 21, 2001

The Honorable Tom Harkin
United States Senate

Subject: Department of the Treasury, Internal Revenue Service: Statement in Preamble to Regulations That Cash Balance Plans Are Not Age-Discriminatory

Dear Senator Harkin:

The preamble to final regulations on pension plans issued by the Internal Revenue Service (IRS), Department of the Treasury, in 1991, included a last-minute addition.[1] A sentence was inserted indicating that IRS would not regard cash balance plans, a type of pension plan, as age discriminatory.[2] Some believe that the sentence may have contributed to an increase in the number of cash balance plans adopted by employers.

You asked us to examine the circumstances surrounding the inclusion of the sentence in the preamble to the regulations. Following discussions with your staff, it was agreed that we would determine whether, by including the sentence, Treasury: (1) acted in accordance with its normal operating procedures, and (2) violated either the Administrative Procedure Act (APA) or a requirement of the Omnibus Budget and Reconciliation Act of 1986 (OBRA '86) that it consult with the Department of Labor (DOL) and the Equal Employment Opportunity Commission (EEOC). To complete this work, we interviewed current and former IRS, Treasury, DOL, and EEOC officials and reviewed documents of those agencies. We researched and analyzed statutory and regulatory requirements and examined pertinent case law. We conducted our analysis between January and December 2000.

---

[1] Nondiscrimination Requirements for Qualified Plans, 56 Fed. Reg. 47,524, 47,528 (1991).

[2] Cash balance plans are pension plans that determine benefits by reference to an employee's hypothetical "cash balance" account based on salary and hypothetical interest credits through normal retirement age.

Summary

We found nothing improper about the inclusion of the preamble sentence. Treasury followed its normal procedures and the sentence reflected the agency's views at the time. We also found that Treasury's addition of the sentence did not violate APA or OBRA '86 requirements. Nevertheless, while the coordination requirement technically was inapplicable, the underlying expectation was for consistency among the three agencies having roles in administering statutes generally prohibiting pension plans from discriminating based on age. Under the circumstances, Treasury should not have opined on whether cash balance plans were age discriminatory in a public manner without having coordinated that position with DOL and EEOC. The preamble sentence may have misled the public and practitioners into believing that the sentence reflected the coordinated views of all three of the responsible agencies. Moreover, the statement may have limited the other agencies' policy options on this issue.

Background

The Tax Reform Act of 1986 made comprehensive changes to the tax code. Among its provisions was an amendment to Internal Revenue Code (I.R.C.) section 401(a)(4) which, in essence, provides that to be eligible for favorable tax treatment, pension plans may not discriminate in favor of highly compensated employees. Final regulations implementing section 401(a)(4) were promulgated in 1991. The preamble to the final regulations discussed a number of comments that had been received on the proposed regulations, including questions seeking clarification on whether cash balance plans could qualify for favorable tax treatment.

Tax statutes classify pension plans as either defined benefit or defined contribution plans and establish separate requirements for the two types of plans.[3] Cash balance plans are often referred to as "hybrid" plans because they combine features of both defined benefit plans and defined contribution plans.[4] Compared with a traditional defined benefit plan that is based on final average pay, cash balance plans provide a larger share of a participant's accumulated benefit earlier in a career. While

---

[3] In a defined benefit plan, the retirement benefit is expressed as an annual payment that would begin at the normal retirement age specified in the plan. In a defined contribution plan, the retirement benefit is expressed as the account balance of an individual participant, which results from contributions that the employer, the worker, or both make and from subsequent investment returns on the assets in the account.

[4] Cash balance plans are not identified in the law, but Internal Revenue Service (IRS) guidance describes a cash balance plan as "a defined benefit plan that defines benefits for each employee by reference to the amount of the employee's hypothetical account balance." 26 C.F.R. § 1.401(a)(4)-8(c)(3)(I).

conversions from traditional defined benefit plans to cash balance plans can increase the value of some workers' benefits, especially younger workers or those who switch jobs frequently, cash balance plans can result in a declining rate of normal retirement benefit accrual over time. This declining accrual rate can result in older workers' receiving lower benefits at retirement from a cash balance plan than they would have received from a traditional final average pay plan.[5]

Section 411(b)(1)(H) of the I.R.C. generally prohibits pension plans from discriminating on the basis of age. Addressing cash balance plans, a sentence in the preamble to the section 401(a) regulations stated: "The fact that interest adjustments through normal retirement age are accrued in the year of the related hypothetical allocation will not cause a cash balance plan to fail to satisfy the requirements of section 411(b)(1)(H), relating to age-based reductions in the rate at which benefits accrue under a plan." In essence, the sentence said that cash balance plans are not age discriminatory. In recent years, cash balance plans have become increasingly common among large corporations for a number of reasons, including reducing total pension costs and increasing portability of retirement benefits to enhance recruitment.

Agency Followed Normal Procedures: Sentence Reflected Views at the Time

The proposed regulation implementing section 401(a) was issued on May 14, 1990, and did not mention cash balance plans. On September 26-28, 1990, the IRS held public hearings on the proposed regulations. Seven commentators urged the IRS to consider developing a "safe harbor" which could be used to test cash balance plans' compliance with the regulations. The IRS did so, in part, by folding a pre-existing working group considering discrimination issues[6] under cash balance plans into the 401(a) regulation project working group. The working group, consisting of Treasury and IRS employees, after much discussion, ultimately reached a consensus view that cash balance plans are not age discriminatory as prohibited by I.R.C. 411(b)(1)(H). While compliance with this section was not the subject of the 401(a) project, the agency officials recognized that compliance with I.R.C. 411(b)(1)(H) was an issue for some practitioners. In light of concerns both within the IRS and Treasury and outside the government, as well as the complexity of the issue, the working group decided

---

[5] See *Private Pensions: Implications of Conversions to Cash Balance Plans* (GAO/HEHS-00-185, Sept. 29, 2000); *Cash Balance Plans: Implications for Retirement Income* (GAO/HEHS-00-207, Sept. 29, 2000).

[6] Within that project, for almost a year before the preamble was published, a working group, made up of people from Treasury and IRS, considered whether cash balance plans could meet I.R.C. nondiscrimination requirements, including section 411(b)(1)(H).

that a concise statement addressing I.R.C. 411(b)(1)(H), without elaboration, should be included in the 401(a) regulation or its preamble.

Although it could not be determined exactly who wrote the sentence in question or when it was done, we can say that it was inserted sometime between August 23 and August 26. IRS advises us that preambles to regulations generally are written late in the promulgation process, as was the case here. IRS sent the regulation draft and preamble to DOL and the Pension Benefit Guaranty Corporation for their review and comment on August 19. This version did not contain the sentence or anything substantively similar. On August 23, a preview copy of the draft of the regulations and preamble was circulated within the IRS. This version of the preamble did not contain the sentence or anything similar. On August 26, the signature draft of the regulations with preamble was completed; the preamble to this draft contains the sentence on section 411(b)(1)(H). The final regulations were published in the Federal Register on September 19, 1991. While the precise circumstances surrounding the insertion of the sentence remain unclear, given the collaborative process employed to develop the regulation, we believe that the sentence in the preamble reflected the views of IRS and Treasury at that time.[7]

APA Notice and Comment Requirement Not Applicable

Generally, under the APA, agencies must give the public notice of any proposed rulemaking in the Federal Register and then give interested persons the opportunity to comment on the proposed rule.[8] However, the APA provides an exception to this requirement for interpretive rules and general statements of policy.[9] We believe that the preamble sentence falls within this exception as an interpretive rule.

The courts have defined an interpretive rule as one that "simply states what the administrative agency thinks the statute means, and only 'reminds' affected parties of existing duties."[10] Generally, an agency can declare its understanding of what a statute requires without providing notice and comment.[11] A rule will be considered interpretive if it represents an agency's explanation of a statutory provision. To

---

[7] It has been reported that a Treasury official who had worked on the regulation left the agency shortly after its publication to accept employment with a law firm that advised employers on pension issues, suggesting that he was responsible for the sentence's inclusion. We found nothing improper in the actions of this official.

[8] 5 U.S.C. § 553(b).

[9] 5 U.S.C. § 553(b)(3)(A).

[10] Citizens to Save Spencer County v. EPA, 600 F. 2d 844, 876 & n.153 (D.C. Cir.1979) (cited with approval in Fertilizer Institute v. EPA, 935 F.2d 1303, 1307 (D.C. Cir. 1991).

[11] Fertilizer Institute, 935 F.2d at 1308.

determine whether a preamble is interpretive, the true emphasis must be on the legal base upon which the rule rests. If a rule is based on a specific statutory provision, it is generally an interpretive rule. This is distinguishable from a so-called "legislative rule" requiring notice and comment, which is based on an agency's power to exercise its judgment as to how best to implement a general legislative mandate. Where a preamble represents an agency's attempt to interpret the meaning of a statutory provision it is proper to conclude that the rule is interpretive.[12]

Applying the principles stated above, we believe that the preamble sentence is an interpretive rule and, therefore, not subject to the APA's notice and comment requirement. In essence, the preamble sentence applies a specific tax code provision, section 411(b)(1)(H), to a specific circumstance–"interest adjustments through normal retirement age are accrued in the year of the related hypothetical allocation"–and expresses Treasury's interpretation that the statute's requirements are not violated by the stated adjustments. Accordingly, the preamble sentence would be considered an interpretive rule under the APA exception.

Other Agencies Unaware of Sentence:
Applicability of OBRA '86 Coordination Requirements

Our review indicated that other agencies were not aware of the addition of the preamble sentence. Neither the IRS nor the EEOC has any record of a draft of the regulation or the preamble being sent to the EEOC. EEOC officials had no recollection of receiving a draft of either document. To the best of their recollection, IRS officials believe that EEOC was not made aware of the regulation or preamble.

As indicated, DOL was provided a draft of the final regulation, but the version of the preamble sent along with it did not contain the sentence in question. None of the officials we talked to at DOL had any recollection of a policy consideration in 1990 or 1991 of the issue of whether cash balance plans were age discriminatory.

OBRA '86 Coordination Requirement Not Applicable

Treasury's failure to make EEOC and DOL aware of the preamble sentence did not violate OBRA '86 because the sentence was not covered by the Act's coordination requirements. Those requirements are found in section 9204(d) of the Act,[13] which provides:

> Interagency Coordination.–The regulations and rulings issued by the Secretary of Labor, the regulations and rulings issued by the Secretary

---

[12] Id. at 1308-09.

[13] Pub. L. No. 99-509 (1986).

> of the Treasury, and the regulations and rulings issued by the Equal Employment Opportunity Commission pursuant to the amendments made by this subtitle shall each be consistent with the others. The Secretary of Labor, the Secretary of the Treasury and the Equal Employment Opportunity Commission shall each consult with the others to the extent necessary to meet the requirements of the preceding sentence. (Emphasis added; "this subtitle" refers to subtitle C of OBRA '86.)

The Act's coordination requirement, therefore, was limited to regulations and rulings issued pursuant to subtitle C of OBRA '86. Subtitle C added section 411(b)(1)(H) to the I.R.C. and added generally parallel provisions to the Employee Retirement Income Security Act of 1974 and the Age Discrimination in Employment Act. Because the September 1991 regulations interpreted section 401(a)(4), and not section 411(b)(1)(H), the interagency coordination requirement did not apply to these regulations. While the preamble sentence discusses section 411(b)(1)(H), the sentence alone is not a "regulation or ruling" subject to the interagency coordination requirement.

Treasury Should Have Coordinated the Preamble Sentence with DOL and EEOC

While the coordination requirement technically was inapplicable, the underlying expectation was for consistency among the three agencies having roles in administering section 411(b)(1)(H). Under the circumstances, Treasury should not have opined on whether cash balance plans were age discriminatory in a public manner without having coordinated that position with DOL and EEOC. The preamble sentence may have misled the public and practitioners into believing that the sentence reflected the coordinated views of all three of the responsible agencies. Moreover, the statement may have limited the other agencies' policy options on this issue. The agencies are continuing to analyze whether cash balance plans are age discriminatory. The continuing regulatory uncertainty surrounding cash balance plans, resulting in part from the preamble sentence, continues to be problematic for employers and plan participants.

Agency Comments

We provided a draft of this letter to IRS, Treasury, DOL, and EEOC for review and comment. IRS, Treasury, and DOL each advised us that they did not have any comments.

EEOC submitted written comments and substantially agreed with much of our draft (see enclosure). However, it disagreed with our conclusion that Treasury did not violate applicable law by not coordinating with EEOC when it issued the final regulation. Specifically, EEOC argues that ORBA '86 required Treasury to coordinate with EEOC before issuing regulations or rulings pursuant to amendments made to

I.R.C. section 411(b)(1)(H), and since the preamble sentence interpreted that section, coordination was required. EEOC also believes that Executive Order 12067 required Treasury to coordinate with it. That order requires agencies to advise and offer to consult with EEOC during the development of any proposed rules, regulations, policies, procedures, or orders concerning equal opportunity.

We continue to believe that our conclusion that Treasury did not violate the OBRA '86 requirement for coordination is correct. We do not read the statute as requiring coordination of a sentence in a preamble to regulations that were not subject to the coordination requirement. The requirement, by its own terms, applies only to regulations or rulings issued pursuant amendments made to I.R.C. section 411(b)(1)(H). Other than the fact that the preamble sentence interprets that section, EEOC has not explained why that one sentence in the preamble, in isolation, should be construed as a "regulation or ruling" subject to the statutory requirement. We have no basis to conclude that the preamble sentence, standing alone, is tantamount to a regulation or ruling as those terms are used in the statute.

With respect to the executive order, compliance with the order was beyond the scope of our review and is essentially a matter of executive branch policy. We point out, in this regard, that IRS does not view the executive order as being applicable to the preamble sentence, and we do not have a basis for disagreeing with them on this point. To the extent that the agencies disagree about matters covered by the order, the order contemplates that such disputes be resolved through the good faith efforts of the affected agencies to reach mutual agreement. Moreover, the order contains a dispute resolution mechanism, which authorizes an agency to refer the matter to the Executive Office of the President.

Copies of this correspondence are being provided to the Honorable Paul H. O'Neill, Secretary of the Treasury; the Honorable Elaine L. Chao, Secretary of Labor; the Honorable Charles O. Rossotti, Commissioner of the Internal Revenue Service; the Honorable Ida L. Castro, Chairwoman, Equal Employment Opportunity Commission; appropriate congressional committees; and others upon request.

If you have any questions regarding this letter, please contact Dayna K. Shah, Acting Associate General Counsel, at (202) 512-8208. Jonathan Barker and Richard Burkard made major contributions to this work.

Sincerely yours,

Anthony H. Gamboa
General Counsel

Enclosure