Vinson & Elkins v. Commissioner, 99 T. C. 9 (1992)

Actuarial assumptions used to determine pension plan funding must be reasonable in the aggregate and represent the actuary's best estimate of anticipated experience under the plan.

Summary

Vinson & Elkins, a law firm, established individual defined benefit (IDB) plans for its partners. The IRS challenged the actuarial assumptions used to calculate contributions, specifically the interest rate, retirement age, preretirement mortality, and postretirement expense load. The Tax Court held that all assumptions were reasonable in the aggregate and represented the actuary's best estimate, thus precluding retroactive changes. The decision emphasized the importance of actuarial conservatism, especially for new plans, and the need to ensure adequate funding for future benefits.

Facts

Vinson & Elkins, a general partnership law firm, adopted IDB plans for the majority of its partners effective September 1, 1984. Each plan had a trust for investment and administration of assets, with contributions made within the required time frame. The IRS challenged the actuarial assumptions used for the 1986 and 1987 plan years, specifically the 5% interest rate, age 62 retirement assumption, the 1958 CSO mortality table for preretirement death benefits, and a 5% postretirement expense load.

Procedural History

The IRS issued notices of final partnership administrative adjustment (FPAA) on April 25, 1990, and April 15, 1991, disallowing deductions for contributions made in 1986 and 1987, respectively. Vinson & Elkins filed petitions for readjustment of partnership items under section 6226 on June 8, 1990, and June 17, 1991. The Tax Court consolidated the cases and rendered a decision in favor of Vinson & Elkins on July 14, 1992.

Issue(s)

1. Whether the 5% pre and postretirement interest rate assumption used by the plans' actuary was reasonable?
2. Whether the age 62 retirement age assumption was reasonable?
3. Whether the use of the 1958 CSO mortality table for preretirement mortality assumptions was reasonable?
4. Whether the 5% postretirement expense load assumption was reasonable?

Holding

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1. Yes, because the 5% interest rate was within the reasonable range considering the long-term nature of the plans and the lack of credible experience.
2. Yes, because age 62 was consistent with Vinson & Elkins' objective to move towards earlier retirement and was within the actuarial mainstream.
3. Yes, because the 1958 CSO table was used to estimate the cost of preretirement death benefits, not to predict actual mortality.
4. Yes, because the 5% expense load was justified by anticipated postretirement expenses and mortality improvement.

Court's Reasoning

The court emphasized that actuarial assumptions must be reasonable in the aggregate and reflect the actuary's best estimate of anticipated experience under section 412(c)(3). The court found the 5% interest rate reasonable, noting that actuaries should be conservative, especially for new plans without credible experience. The age 62 retirement assumption was deemed reasonable, aligning with Vinson & Elkins' policy to encourage earlier retirement. The use of the 1958 CSO table for preretirement mortality was upheld because it was used to estimate the cost of death benefits, not predict actual mortality. The 5% postretirement expense load was found reasonable due to anticipated expenses and to account for mortality improvement not reflected in the 1971 IAM table used for postretirement mortality. The court rejected the IRS's argument that tax motivation invalidated the assumptions, affirming that taxpayers may arrange their affairs to minimize taxes.

Practical Implications

This decision underscores the importance of actuarial conservatism in ensuring pension plans are adequately funded over the long term. It provides guidance on the reasonableness of actuarial assumptions, particularly for new plans, and supports the use of conservative assumptions to mitigate the risk of underfunding. The ruling also affirms that tax considerations do not inherently invalidate actuarial assumptions. Practitioners should be aware that actuarial assumptions will be upheld if they fall within a reasonable range and reflect the actuary's best estimate, even if they are conservative. This case has been cited in subsequent rulings to support the use of conservative assumptions in pension plan funding.

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