DESCRIPTION OF H.R. 2830, THE "PENSION PROTECTION ACT OF 2005," AS ORDERED REPORTED BY THE SUBCOMMITTEE ON EMPLOYER-EMPLOYEE RELATIONS OF THE HOUSE COMMITTEE ON EDUCATION AND THE WORKFORCE

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The Subcommittee on Employer-Employee Relations of the House Committee on Education and the Workforce held a markup of H.R. 2830, the "Pension Protection Act of 2005," on June 22, 2005. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the Subcommittee Chairman's amendment in the nature of a substitute to H.R. 2830,[2] which was adopted by the subcommittee by voice vote. As so amended, the bill was ordered favorably reported to the full committee by voice vote.

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[1] This document may be cited as follows: Joint Committee on Taxation, *Description of H.R. 2830, the "Pension Protection Act of 2005," as Ordered Reported by the Subcommittee on Employer-Employee Relations of the House Committee on Education and the Workforce* (JCX-48-05), June 23, 2005.

[2] H.R. 2830 includes provisions that amend the Employee Retirement Income Security Act and the Internal Revenue Code. The Chairman's mark does not affect provisions of the bill that amend the Internal Revenue Code. The description of Internal Revenue Code provisions in this document refer to the provisions as in the introduced bill.

I. REFORM OF FUNDING RULES FOR SINGLE-EMPLOYER DEFINED BENEFIT PENSION PLANS

A. Minimum Funding Standards for Single-Employer Defined Benefit Pension Plans

Present Law

In general

Single-employer defined benefit pension plans are subject to minimum funding requirements under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code (the "Code").[3] The amount of contributions required for a plan year under the minimum funding rules is generally the amount needed to fund benefits earned during that year plus that year's portion of other liabilities that are amortized over a period of years, such as benefits resulting from a grant of past service credit. The amount of required annual contributions is determined under one of a number of acceptable actuarial cost methods. Additional contributions are required under the deficit reduction contribution rules in the case of certain underfunded plans. No contribution is required under the minimum funding rules in excess of the full funding limit (described below).

General minimum funding rules

Funding standard account

As an administrative aid in the application of the funding requirements, a defined benefit pension plan is required to maintain a special account called a "funding standard account" to which specified charges and credits are made for each plan year, including a charge for normal cost and credits for contributions to the plan. Other credits or charges or credits may apply as a result of decreases or increases in past service liability as a result of plan amendments, experience gains or losses, gains or losses resulting from a change in actuarial assumptions, or a waiver of minimum required contributions.

In determining plan funding under an actuarial cost method, a plan's actuary generally makes certain assumptions regarding the future experience of a plan. These assumptions typically involve rates of interest, mortality, disability, salary increases, and other factors affecting the value of assets and liabilities. If the plan's actual unfunded liabilities are less than

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[3] ERISA secs. 301-308; Code sec. 412. The minimum funding rules also apply to multiemployer plans, but the rules for multiemployer plans differ in various respects from the rules applicable to single-employer plans. The rules for multiemployer plans are discussed in Part II of this document. The minimum funding rules do not apply to governmental plans or to church plans, except church plans with respect to which an election has been made to have various ERISA and Code requirements, including the funding requirements, apply to the plan. In addition, special rules apply to certain plans funded exclusively by the purchase of individual insurance contracts (referred to as "insurance contract" plans).

those anticipated by the actuary on the basis of these assumptions, then the excess is an experience gain. If the actual unfunded liabilities are greater than those anticipated, then the difference is an experience loss. Experience gains and losses for a year are generally amortized as credits or charges to the funding standard account over five years.

If the actuarial assumptions used for funding a plan are revised and, under the new assumptions, the accrued liability of a plan is less than the accrued liability computed under the previous assumptions, the decrease is a gain from changes in actuarial assumptions. If the new assumptions result in an increase in the accrued liability, the plan has a loss from changes in actuarial assumptions. The accrued liability of a plan is the actuarial present value of projected pension benefits under the plan that will not be funded by future contributions to meet normal cost or future employee contributions. The gain or loss for a year from changes in actuarial assumptions is amortized as credits or charges to the funding standard account over ten years.

If minimum required contributions are waived (as discussed below), the waived amount (referred to as a "waived funding deficiency") is credited to the funding standard account. The waived funding deficiency is then amortized over a period of five years, beginning with the year following the year in which the waiver is granted. Each year, the funding standard account is charged with the amortization amount for that year unless the plan becomes fully funded.

If, as of the close of a plan year, the funding standard account reflects credits at least equal to charges, the plan is generally treated as meeting the minimum funding standard for the year. If, as of the close of the plan year, charges to the funding standard account exceed credits to the account, then the excess is referred to as an "accumulated funding deficiency." Thus, as a general rule, the minimum contribution for a plan year is determined as the amount by which the charges to the funding standard account would exceed credits to the account if no contribution were made to the plan. For example, if the balance of charges to the funding standard account of a plan for a year would be $200,000 without any contributions, then a minimum contribution equal to that amount would be required to meet the minimum funding standard for the year to prevent an accumulated funding deficiency.

Credit balances

If credits to the funding standard account exceed charges, a "credit balance" results. A credit balance results, for example, if contributions in excess of minimum required contributions are made. Similarly, a credit balance may result from large net experience gains. The amount of the credit balance, increased with interest at the rate used under the plan to determine costs, can be used to reduce future required contributions.

Funding methods and general concepts

A defined benefit pension plan is required to use an acceptable actuarial cost method to determine the elements included in its funding standard account for a year. Generally, an actuarial cost method breaks up the cost of benefits under the plan into annual charges consisting of two elements for each plan year. These elements are referred to as: (1) normal cost; and (2) supplemental cost.

The plan's normal cost for a plan year generally represents the cost of future benefits allocated to the year by the funding method used by the plan for current employees and, under some funding methods, for separated employees. Specifically, it is the amount actuarially determined that would be required as a contribution by the employer for the plan year in order to maintain the plan if the plan had been in effect from the beginning of service of the included employees and if the costs for prior years had been paid, and all assumptions as to interest, mortality, time of payment, etc., had been fulfilled. The normal cost will be funded by future contributions to the plan: (1) in level dollar amounts; (2) as a uniform percentage of payroll; (3) as a uniform amount per unit of service (e.g., $1 per hour); or (4) on the basis of the actuarial present values of benefits considered accruing in particular plan years.

The supplemental cost for a plan year is the cost of future benefits that would not be met by future normal costs, future employee contributions, or plan assets. The most common supplemental cost is that attributable to past service liability, which represents the cost of future benefits under the plan: (1) on the date the plan is first effective; or (2) on the date a plan amendment increasing plan benefits is first effective. Other supplemental costs may be attributable to net experience losses, changes in actuarial assumptions, and amounts necessary to make up funding deficiencies for which a waiver was obtained. Supplemental costs must be amortized (i.e., recognized for funding purposes) over a specified number of years, depending on the source. For example, the cost attributable to a past service liability is generally amortized over 30 years.

Normal costs and supplemental costs under a plan are computed on the basis of an actuarial valuation of the assets and liabilities of a plan. An actuarial valuation is generally required annually and is made as of a date within the plan year or within one month before the beginning of the plan year. However, a valuation date within the preceding plan year may be used if, as of that date, the value of the plan's assets is at least 100 percent of the plan's current liability (i.e., the present value of benefit liabilities under the plan, as described below).

For funding purposes, the actuarial value of plan assets may be used, rather than fair market value. The actuarial value of plan assets is the value determined under a reasonable actuarial valuation method that takes into account fair market value and is permitted under Treasury regulations. Any actuarial valuation method used must result in a value of plan assets that is not less than 80 percent of the fair market value of the assets and not more than 120 percent of the fair market value. In addition, if the valuation method uses average value of the plan assets, values may be used for a stated period not to exceed the five most recent plan years, including the current year.

In applying the funding rules, all costs, liabilities, interest rates, and other factors are required to be determined on the basis of actuarial assumptions and methods, each of which is reasonable (taking into account the experience of the plan and reasonable expectations), or which, in the aggregate, result in a total plan contribution equivalent to a contribution that would

be obtained if each assumption and method were reasonable. In addition, the assumptions are required to offer the actuary's best estimate of anticipated experience under the plan.[4]

Additional contributions for underfunded plans

In general

Under special funding rules (referred to as the "deficit reduction contribution" rules),[5] an additional charge to a plan's funding standard account is generally required for a plan year if the plan's funded current liability percentage for the plan year is less than 90 percent.[6] A plan's "funded current liability percentage" is generally the actuarial value of plan assets as a percentage of the plan's current liability.[7] In general, a plan's current liability means all liabilities to employees and their beneficiaries under the plan, determined on a present-value basis.

The amount of the additional charge required under the deficit reduction contribution rules is the sum of two amounts: (1) the excess, if any, of (a) the deficit reduction contribution (as described below), over (b) the contribution required under the normal funding rules; and (2) the amount (if any) required with respect to unpredictable contingent event benefits. The amount of the additional charge cannot exceed the amount needed to increase the plan's funded current liability percentage to 100 percent (taking into account any expected increase in current liability due to benefits accruing during the plan year).

The deficit reduction contribution is the sum of (1) the "unfunded old liability amount," (2) the "unfunded new liability amount," and (3) the expected increase in current liability due to benefits accruing during the plan year.[8] The "unfunded old liability amount" is the amount

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[4] Under present law, certain changes in actuarial assumptions that decrease the liabilities of an underfunded single-employer plan must be approved by the Secretary of the Treasury.

[5] The deficit reduction contribution rules apply to single-employer plans, other than single-employer plans with no more than 100 participants on any day in the preceding plan year. Single-employer plans with more than 100 but not more than 150 participants are generally subject to lower contribution requirements under these rules.

[6] Under an alternative test, a plan is not subject to the deficit reduction contribution rules for a plan year if (1) the plan's funded current liability percentage for the plan year is at least 80 percent, and (2) the plan's funded current liability percentage was at least 90 percent for each of the two immediately preceding plan years or each of the second and third immediately preceding plan years.

[7] In determining a plan's funded current liability percentage for a plan year, the value of the plan's assets is generally reduced by the amount of any credit balance under the plan's funding standard account. However, this reduction does not apply in determining the plan's funded current liability percentage for purposes of whether an additional charge is required under the deficit reduction contribution rules.

[8] If the Secretary of the Treasury prescribes a new mortality table to be used in determining current liability, as described below, the deficit reduction contribution may include an additional amount.

needed to amortize certain unfunded liabilities under 1987 and 1994 transition rules. The "unfunded new liability amount" is the applicable percentage of the plan's unfunded new liability. Unfunded new liability generally means the unfunded current liability of the plan (i.e., the amount by which the plan's current liability exceeds the actuarial value of plan assets), but determined without regard to certain liabilities (such as the plan's unfunded old liability and unpredictable contingent event benefits). The applicable percentage is generally 30 percent, but decreases by .40 of one percentage point for each percentage point by which the plan's funded current liability percentage exceeds 60 percent. For example, if a plan's funded current liability percentage is 85 percent (i.e., it exceeds 60 percent by 25 percentage points), the applicable percentage is 20 percent (30 percent minus 10 percentage points (25 multiplied by .4)).[9]

A plan may provide for unpredictable contingent event benefits, which are benefits that depend on contingencies that are not reliably and reasonably predictable, such as facility shutdowns or reductions in workforce. The value of any unpredictable contingent event benefit is not considered in determining additional contributions until the event has occurred. The event on which an unpredictable contingent event benefit is contingent is generally not considered to have occurred until all events on which the benefit is contingent have occurred.

Required interest rate and mortality table

Specific interest rate and mortality assumptions must be used in determining a plan's current liability for purposes of the special funding rule. For plans years beginning before January 1, 2004, the interest rate used to determine a plan's current liability must be within a permissible range of the weighted average[10] of the interest rates on 30-year Treasury securities for the four-year period ending on the last day before the plan year begins. The permissible range is generally from 90 percent to 105 percent (120 percent for plan years beginning in 2002 or 2003).[11] The interest rate used under the plan generally must be consistent with the assumptions which reflect the purchase rates which would be used by insurance companies to satisfy the liabilities under the plan.[12]

[9] In making these computations, the value of the plan's assets is reduced by the amount of any credit balance under the plan's funding standard account.

[10] The weighting used for this purpose is 40 percent, 30 percent, 20 percent and 10 percent, starting with the most recent year in the four-year period. Notice 88-73, 1988-2 C.B. 383.

[11] If the Secretary of the Treasury determines that the lowest permissible interest rate in this range is unreasonably high, the Secretary may prescribe a lower rate, but not less than 80 percent of the weighted average of the 30-year Treasury rate.

[12] ERISA sec. 302(b)(5)(B)(iii)(II); Code sec. 412(b)(5)(B)(iii)(II). Under Notice 90-11, 1990-1 C.B. 319, the interest rates in the permissible range are deemed to be consistent with the assumptions reflecting the purchase rates that would be used by insurance companies to satisfy the liabilities under the plan.

Under the Pension Funding Equity Act of 2004 ("PFEA 2004"),[13] a special interest rate applies in determining current liability for plan years beginning in 2004 or 2005.[14] For these years, the interest rate used must be within a permissible range of the weighted average of the rates of interest on amounts invested conservatively in long-term investment-grade corporate bonds during the four-year period ending on the last day before the plan year begins. The permissible range for these years is from 90 percent to 100 percent. The interest rate is to be determined by the Secretary of the Treasury on the basis of two or more indices that are selected periodically by the Secretary and are in the top three quality levels available.

The Secretary of the Treasury is required to prescribe mortality tables and to periodically review (at least every five years) and update such tables to reflect the actuarial experience of pension plans and projected trends in such experience.[15] The Secretary of the Treasury has required the use of the 1983 Group Annuity Mortality Table.[16]

Other rules

Full funding limitation

No contributions are required under the minimum funding rules in excess of the full funding limitation. The full funding limitation is the excess, if any, of (1) the accrued liability under the plan (including normal cost), over (2) the lesser of (a) the market value of plan assets or (b) the actuarial value of plan assets.[17] However, the full funding limitation may not be less

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[13] Pub. L. No. 108-218 (2004).

[14] In addition, under PFEA 2004, if certain requirements are met, reduced contributions under the deficit reduction contribution rules apply for plan years beginning after December 27, 2003, and before December 28, 2005, in the case of plans maintained by commercial passenger airlines, employers primarily engaged in the production or manufacture of a steel mill product or in the processing of iron ore pellets, or a certain labor organization.

[15] ERISA sec. 302(d)(7)(C)(ii); Code sec. 412(l)(7)(C)(ii).

[16] Rev. Rul. 95-28, 1995-1 C.B. 74. The IRS and the Treasury Department have announced that they are undertaking a review of the applicable mortality table and have requested comments on related issues, such as how mortality trends should be reflected. Notice 2003-62, 2003-38 I.R.B. 576; Announcement 2000-7, 2000-1 C.B. 586.

[17] For plan years beginning before 2004, the full funding limitation was generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) a percentage (170 percent for 2003) of the plan's current liability (including the current liability normal cost), over (2) the lesser of (a) the market value of plan assets or (b) the actuarial value of plan assets, but in no case less than the excess, if any, of 90 percent of the plan's current liability over the actuarial value of plan assets. Under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), the full funding limitation based on 170 percent of current liability is repealed for plan years beginning in 2004 and thereafter. The provisions of EGTRRA generally do not apply for years beginning after December 31, 2010.

than the excess, if any, of 90 percent of the plan's current liability (including the current liability normal cost) over the actuarial value of plan assets. In general, current liability is all liabilities to plan participants and beneficiaries accrued to date, whereas the accrued liability under the full funding limitation may be based on projected future benefits, including future salary increases.

Timing of plan contributions

In general, plan contributions required to satisfy the funding rules must be made within 8½ months after the end of the plan year. If the contribution is made by such due date, the contribution is treated as if it were made on the last day of the plan year.

In the case of a plan with a funded current liability percentage of less than 100 percent for the preceding plan year, estimated contributions for the current plan year must be made in quarterly installments during the current plan year.[18] The amount of each required installment is 25 percent of the lesser of (1) 90 percent of the amount required to be contributed for the current plan year or (2) 100 percent of the amount required to be contributed for the preceding plan year.[19]

Funding waivers

Within limits, the Secretary of the Treasury is permitted to waive all or a portion of the contributions required under the minimum funding standard for a plan year (a "waived funding deficiency").[20] A waiver may be granted if the employer (or employers) responsible for the contribution could not make the required contribution without temporary substantial business hardship and if requiring the contribution would be adverse to the interests of plan participants in the aggregate. Generally, no more than three waivers may be granted within any period of 15 consecutive plan years.

The IRS is authorized to require security to be granted as a condition of granting a waiver of the minimum funding standard if the sum of the plan's accumulated funding deficiency and the balance of any outstanding waived funding deficiencies exceeds $1 million.

Failure to make required contributions

An employer is generally subject to an excise tax if it fails to make minimum required contributions and fails to obtain a waiver from the IRS.[21] The excise tax is 10 percent of the

[18] ERISA sec. 302(e); Code sec. 412(m).

[19] If quarterly contributions are required with respect to a plan, the amount of a quarterly installment must also be sufficient to cover any shortfall in the plan's liquid assets (a "liquidity shortfall").

[20] ERISA sec. 303; Code sec. 412(d). Under similar rules, the amortization period applicable to net experience losses may also be extended.

[21] Code sec. 4971. An excise tax applies also if a quarterly installment is less than the amount required to cover the plan's liquidity shortfall.

amount of the funding deficiency. In addition, a tax of 100 percent may be imposed if the funding deficiency is not corrected within a certain period.

If the total of the contributions the employer fails to make (plus interest) exceeds $1 million and the plan's funded current liability percentage is less than 100 percent, a lien arises in favor of the plan with respect to all property of the employer and the members of the employer's controlled group. The amount of the lien is the total amount of the missed contributions (plus interest).

Description of Proposal

In general

In the case of single-employer defined benefit plans, the proposal repeals the present-law funding rules (including the requirement that a funding standard account be maintained) and provides a new set of rules for determining minimum required contributions.[22] Under the proposal, the minimum required contribution to a single-employer defined benefit pension plan for a plan year generally depends on a comparison of the value of the plan's assets with the plan's funding target. As described in more detail below, under the proposal, credit balances generated under present law are carried over (into the "funding standard carryover balance") and generally may be used in certain circumstances to reduce otherwise required minimum contributions. In addition, as described more fully below, contributions in excess of the minimum contributions required under the proposal generally are credited to a prefunding balance that may be used in certain circumstances to reduce otherwise required minimum contributions. To facilitate the use of such balances to reduce minimum required contributions, while avoiding use of such balances for more than one purpose, in some circumstances the value of plan assets is reduced by the prefunding balance and/or the funding standard carryover balance.

[22] The proposal does not change the funding rules applicable to insurance contract plans. Proposed changes to the funding rules for multiemployer plans are discussed in Part II below. Governmental plans and church plans continue to be exempt from the funding rules to the extent provided under present law.

The minimum required contribution for a plan year, based on the value of plan assets compared to the funding target is shown in the following table:

If:	***The minimum required contribution is:***
the value of plan assets (reduced by the prefunding balance if the employer has elected to use such balance to reduce minimum required contributions) is less than the funding target,	the sum of: (1) target normal cost; (2) the shortfall amortization charge; and (3) any waiver amortization charge.
the value of plan assets (reduced by the prefunding balance and funding standard carryover balance) exceeds the funding target,	the target normal cost, reduced by the excess of (1) the value of plan assets (reduced by the prefunding balance and funding standard carryover balance), over (2) the funding target.
the value of plan assets (reduced by the prefunding balance and funding standard carryover balance) equals the funding target,	the target normal cost.

Under the proposal, a plan's funding target is the present value of all liabilities under the plan attributable to benefits accrued or earned as of the beginning of the plan year. A plan's target normal cost for a plan year is the present value of benefits expected to accrue or be earned during the plan year. A shortfall amortization charge is the amount required to amortize a funding shortfall. In general, a plan has a funding shortfall for a plan year if the plan's funding target for the year exceeds the value of the plan's assets. A waiver amortization charge is the amount required to amortize a waiver funding deficiency.

The proposal specifies the interest rates and mortality table that must be used in determining a plan's target normal cost and funding target, as well as certain other actuarial assumptions, including special assumptions if the value of a plan's assets (reduced by the prefunding and funding standard carryover balances) is less than 60 percent of the plan's funding target (an "at-risk" plan).

Target normal cost

Under the proposal, the minimum required contribution for a plan year generally includes the plan's target normal cost for the plan year. A plan's target normal cost is the present value of benefits expected to accrue or be earned under the plan during the plan year (the "current" year). For this purpose, an increase in any benefit attributable to services performed in a preceding year by reason of a compensation increase during the current year is treated as having accrued in the current year.

If the value of a plan's assets (reduced by the funding standard carryover balance and prefunding balance) exceeds the plan's funding target for a plan year, for purposes of determining the minimum required contribution for the plan year, normal cost is reduced by the excess.

Funding target and shortfall amortization charges

In general

If the value of a plan's assets (reduced by the prefunding balance if the employer elects to use the prefunding balance to reduce required contributions for the year) is less than the plan's funding target for a plan year, the minimum required contribution is increased by a shortfall amortization charge. As discussed more fully below, the shortfall amortization charge is the aggregate of the annual installments for the plan year with respect to any shortfall amortization bases for the plan year and the six preceding plan years.

Funding target

A plan's funding target for a plan year is the present value of all liabilities to participants and their beneficiaries under the plan for the plan year. For this purpose, liabilities are taken into account to the extent attributable to benefits (including any early retirement or similar benefits) accrued or earned as of the beginning of the plan year. Benefits accruing in the plan year are not taken into account, irrespective of whether the valuation date for the plan year is later than the first day of the plan year.[23]

Shortfall amortization charge

The shortfall amorization charge for a plan year is the aggregate of the shortfall amortization installments for the plan year with respect to any shortfall amortization bases for that plan year and the six preceding plan years. The shortfall amortization installments with respect to a shortfall amortization base for a plan year are annual installments determined as the amount needed to amortize the shortfall amortization base in level annual installments over the seven-year period beginning with the plan year. The shortfall amortization installments for a plan year are determined as of the valuation date for the plan year, using the appropriate segment interest rates for the plan year (discussed below).

A shortfall amortization base is determined for a plan year based on the plan's funding shortfall for the plan year, that is, the amount by which the plan's funding target for the year exceeds the value of the plan's assets (reduced by the funding standard carryover balance and prefunding balance). The shortfall amortization base is the excess of (1) the funding shortfall, over (2) the present value of (a) the aggregate shortfall amortization installments for the plan year and the five succeeding plan years that have been determined with respect to any shortfall amortization bases for each of the six preceding plan years and (b) the aggregate waiver amortization installments (discussed below) for the plan year and the four succeeding plan years that have been determined with respect to any waived funding deficiency for each of the five preceding plan years.

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[23] Benefits accruing during the plan year are taken into account in determining normal cost for the plan year.

Early deemed amortization of funding shortfalls for preceding years

If the value of the plan's assets (reduced by the funding standard carryover balance and prefunding balance) exceeds the plan's funding target for the year, so that the plan does not have a funding shortfall, any shortfall amortization bases for preceding plan years are eliminated. In that case, for purposes of determining any shortfall amortization charges for that year and succeeding years, the shortfall amortization base for preceding years is zero.

Actuarial assumptions used in determining a plan's target normal cost and funding target

Interest rates

The proposal specifies the interest rates that must be used in determining a plan's target normal cost and funding target. Under the proposal, present value is determined using three interest rates ("segment" rates), each of which applies to benefit payments expected to be made from the plan during a certain period. The first segment rate applies to payments expected to be made during the five-year period beginning on the first day of the plan year; the second segment rate applies to payments expected to be made during the 15-year period following the initial five-year period; and the third segment rate applies to payments expected to be made after the end of the 15-year period. Each segment rate is a single interest rate determined monthly by the Secretary of the Treasury on the basis of a corporate bond yield curve, taking into account only the portion of the yield curve based on corporate bonds maturing during the particular segment rate period.

The corporate bond yield curve used for this purpose is to be prescribed on a monthly basis by the Secretary of the Treasury, reflecting a three-year weighted average of yields on investment grade corporate bonds with varying maturities. The three-year weighted average is determined using an averaging methodology under which the most recent year is weighted 50 percent, the preceding year is weighted 35 percent, and the second preceding year is weighted 15 percent.

The Secretary of the Treasury is directed to publish each month the corporate bond yield curve and each of the segment rates for the month. In addition, such Secretary is directed to publish a description of the methodology used to determine the yield curve and segment rates, which is sufficiently detailed to enable plans to make reasonable projections regarding the yield curve and segment rates for future months.

Under the proposal, the present value of liabilities under a plan is determined using the segment rates for the "applicable month" for the plan year. The applicable month is the month that includes the plan's valuation date for the plan year, or, at the election of the plan administrator, any of the four months preceding the month that includes the valuation date. An election of a preceding month applies to the plan year for which it is made and all succeeding plan years unless revoked with the consent of the Secretary of the Treasury.

The proposal provides a transition rule for plan years beginning in 2006 and 2007. Under this rule, for plan year's beginning in 2006, the first, second, or third segment rate with respect to any month is the sum of: (1) the product of the segment rate otherwise determined for the month, multiplied by the 33-⅓ percent; and (2) the product of the interest rate applicable in

determining current liability for plan years beginning in 2005 under present law,[24] multiplied by 66-⅔ percent. For plan year's beginning in 2007, the first, second, or third segment rate with respect to any month is the sum of: (1) the product of the segment rate otherwise determined for the month, multiplied by the 66-⅔ percent; and (2) the product of the interest rate applicable in determining current liability for plan years beginning in 2005 under present law, multiplied by 33-⅓ percent.

Under the proposal, certain amounts are determined using the plan's "effective interest rate" for a plan year. The effective interest rate with respect to a plan for a plan year is the single rate of interest which, if used to determine the present value of the liabilities taken into account in determining the plan's funding target for the year, would result in an amount equal to the plan's funding target (as determined using the first, second, and third segment rates).

Mortality table

The proposal specifies the mortality table that must be used in determining present value or making any other computations. In general, the mortality table used must be the RP-2000 Combined Mortality Table, as published by the Society of Actuaries, as in effect on the date of the enactment of the proposal. Under Treasury regulations, any difference in mortality assumptions under this required mortality table and the table used in determining current liability for plan years beginning in 2005 is to be phased in ratably over the first five plan years beginning in or after 2006, so as to be fully effective for the fifth plan year.

The Secretary of the Treasury is directed to make revisions at least every 10 years in any tables in effect under the proposal to reflect the actual experience of pension plans and projected trends in such experience.

Other assumptions

Under the proposal, in determining any present value or making any computation, the probability that future benefits will be paid in optional forms of benefit provided under the plan must be taken into account (including the probability of lump-sum distributions determined on the basis of the plan's experience and other related assumptions). In addition, there must be taken into account any difference in the present value of future benefit payments resulting from the use, in determining optional forms of benefits, of interest and mortality assumptions different from those required to be used under the minimum funding rules.

The proposal generally does not require other specified assumptions to be used in determining the plan's target normal cost and funding target except in the case of at-risk plans (discussed below). However, similar to present law, the determination of present value or other computation must be made on the basis of actuarial assumptions and methods, each of which is

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[24] The interest rate applicable in determining current liability for plan years beginning in 2005 must be within a permissible range (from 90 to 100 percent) of the weighted average of the rates of interest on amounts invested conservatively in long-term investment-grade corporate bonds during the four-year period ending on the last day before the plan year begins.

reasonable (taking into account the experience of the plan and reasonable expectations), and which, in combination, offer the actuary's best estimate of anticipated experience under the plan.[25]

Special assumptions for at-risk plans

The proposal applies special rules in determining the funding target and normal cost of a plan in at-risk status. A plan is in at-risk status for a plan year if the plan's funding target attainment percentage for the preceding year was less than 60 percent. A plan's funding target attainment percentage for a plan year is the ratio, expressed as a percentage, that the value of the plan's assets (reduced by the funding standard carryover balance and prefunding balance) bears to the plan's funding target for the year. For this purpose, the plan's funding target is determined using the actuarial assumptions for plans that are not at-risk.

The funding target of a plan in at-risk status for a plan year is generally the sum of: (1) the present value of all liabilities to participants and beneficiaries under the plan for the plan year, determined using (in addition to the normally required assumptions) an assumption that all participants will elect benefits at the times and in the forms as will result in the highest present value of liabilities, plus (2) a loading factor. The loading factor is the sum of (1) $700 times the number of participants in the plan, plus (2) four percent of the funding target determined without regard to the loading factor.[26]

The target normal cost of a plan in at-risk status for a plan year is generally the sum of: (1) the present value of benefits expected to accrue or be earned under the plan during the plan year, determined using (in addition to the normally required assumptions) an assumption that all participants will elect benefits at the times and in the forms that will result in the highest present value, plus (2) a loading factor. The loading factor is four percent of the target normal cost determined without regard to the loading factor.[27]

If a plan has been in at-risk status for fewer than five consecutive plan years, the amount of a plan's funding target or target normal cost for a plan year is determined as the sum of: (1) the amount of the funding target or target normal cost determined without regard to the at-risk rules, plus (2) the transition percentage for the plan year of the excess the amount of the funding target or target normal cost determined under the at-risk rules over the amount determined without regard to the at-risk rules. The transition percentage is the product of 20 percent times the number of consecutive plan years for which the plan has been in at-risk status.

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[25] The proposal retains the present-law rule under which certain changes in actuarial assumptions that decrease the liabilities of an underfunded single-employer plan must be approved by the Secretary of the Treasury.

[26] This loading factor is intended to reflect the cost of purchasing group annuity contracts in the case of termination of the plan.

[27] Target normal cost for a plan in at-risk status does not include a loading factor of $700 per plan participant.

Amortization of a waived funding deficiency

The proposal retains the present-law rules under which the Secretary of the Treasury may waive all or a portion of the contributions required under the minimum funding standard for a plan year (referred to as a "waived funding deficiency").[28] If a plan has a waived funding deficiency for a plan year or any of the four preceding plan years, the minimum required contribution for the plan year is increased by the waiver amortization charge for the plan year.

The waiver amortization charge for a plan year is the aggregate total of the waiver amortization installments for the plan year with respect to any waiver amortization bases for the five preceding plan years. The waiver amortization installments with respect to a waiver amortization base for a plan year are annual installments determined as the amount needed to amortize the waiver amortization base in level annual installments over the over the five-year period beginning with the following plan year. The waiver amortization payments for a plan year are determined as of the valuation date for the plan year, using the appropriate segment interest rates for the plan year. The waiver amortization base for a plan year is the amount of the waived funding deficiency (if any) for the plan year.

If the value of the plan's assets (reduced by the funding standard carryover balance and prefunding balance) exceeds the plan's funding target for the year, so that the plan does not have a funding shortfall, any waiver amortization bases for preceding plan years are eliminated. In that case, for purposes of determining any waiver amortization charges for that year and succeeding years, the waiver amortization base for preceding years is zero.

Funding standard carryover balance or prefunding balance

In general

If the value of a plan's assets (reduced by the prefunding balance) is at least 80 percent of the plan's funding target, the plan sponsor may elect to credit all or a portion of the funding standard carryover balance or prefunding balance, determined as of the valuation date for the current plan year, against the minimum required contribution for the current plan year, thus reducing the amount that must be contributed for the current year.

Funding standard carryover balance

In the case of a single-employer plan that was in effect for a plan year beginning in 2005 and, as of the end of the 2005 plan year, had a positive balance in the funding standard account maintained under the funding rules as in effect for 2005, the plan sponsor must maintain a funding standard carryover balance. The funding standard carryover balance consists of a beginning balance in the amount of the positive balance in the funding standard account as of the end of the 2005 plan year, decreased (as described below) and adjusted to reflect the rate of net gain or loss on plan assets.

[28] In the case of single-employer plans, the proposal repeals the present-law rules under which the amortization period applicable to losses may be extended.

As of the valuation date for each plan year beginning after 2006, the funding standard carryover balance of a plan is decreased (but not below zero) by the sum of: (1) any amount credited to reduce the minimum required contribution for the plan year, plus (2) any amount elected by the plan sponsor as a reduction in the funding standard carryover balance, so that the value of plan assets is not required to be reduced by that amount in determining minimum required contributions.

Prefunding balance

The plan sponsor must maintain the prefunding balance, which consists of a beginning balance of zero, increased and decreased (as described below) and adjusted to reflect the rate of net gain or loss on plan assets.

As of the valuation date for each plan year beginning after 2006, the prefunding balance of a plan is increased by the amount elected by the plan sponsor, not to exceed: (1) the excess (if any) of the aggregate total employer contributions for the preceding plan year, over (2) the minimum required contribution for the preceding plan year. For this purpose, the minimum required contribution for the preceding plan year is increased by interest, at the plan's effective rate for the preceding plan year, on any portion of the required contribution remaining unpaid, for the period beginning with the first day of the preceding plan year and ending on the date that the unpaid portion of the contribution is made.

As of the valuation date for each plan year beginning after 2006 (the "current" plan year), the prefunding balance of a plan is decreased (but not below zero) by the sum of: (1) any amount credited to reduce the minimum required contribution for the plan year, plus (2) any amount elected by the plan sponsor as a reduction in the prefunding balance, so that the value of plan assets is not required to be reduced by that amount in determining minimum required contributions. As discussed above, if the prefunding balance is used to reduce a minimum required contribution, the value of plan assets must be reduced by the prefunding balance in determining whether a shortfall amortization charge is required (i.e., whether the value of plan assets for a plan year is less than the plan's funding target for the plan year). Thus, the prefunding balance may not be included in the value of plan assets in order to avoid a shortfall amortization charge for a plan year and also used to reduce the minimum required contribution for the same year.

Other rules

In determining the prefunding balance or funding standard carryover balance as of the valuation date for a plan year (before applying any increase or decrease as described above), the plan sponsor must adjust the balance in accordance with regulations prescribed by the Secretary of the Treasury, to reflect the rate of net gain or loss on plan assets. The rate of net gain or loss is determined on the basis of the fair market value of the plan assets and the gain or loss experienced by all plan assets for the period beginning with the valuation date for the preceding plan year and ending with the date preceding the valuation date for the current plan year, properly taking into account, in accordance with regulations, all contributions, distributions, and other plan payments made during the period.

If a plan has a funding standard carryover balance of more than zero for a plan year, none of the plan's prefunding balance may be credited to reduce a minimum required contribution, nor may an election be made to reduce the prefunding balance for purposes of determining the value of plan assets or any other purpose in determining minimum required contributions. Thus, the funding standard carryover balance must be used for these purposes before the prefunding balance may be used.

Any election relating to the prefunding balance and funding standard carryover balance is to be made in such form and manner as the Secretary of the Treasury prescribes.

Other rules and definitions

Valuation date

Under the proposal, all determinations made with respect to minimum required contributions for a plan year (such as the value of plan assets and liabilities) must be made as of the plan's valuation date for the plan year. In general, the valuation date for a plan year must be the first day of the plan year. However, any day in the plan year may be designated as the plan's valuation date if, on each day during the preceding plan year, the plan had 500 or fewer participants.[29] For this purpose, all defined benefit pension plans (other than multiemployer plans) maintained by the same employer (or a predecessor employer), or by any member of such employer's controlled group, are treated as a single plan, but only employees of such employer or controlled group member are taken into account.

Value of plan assets

The proposal allows the value of plan assets to be determined on the basis of any reasonable actuarial valuation method as under present law, with certain modifications. Any actuarial valuation method used may not result in a determination of the value of plan assets that at any time is less than 90 percent or more than 110 percent of the fair market value of the assets at that time. In addition, a valuation method may not provide for averaging of fair market values over more than the three most recent plan years (including the current year).

If a required contribution for a preceding plan year is made after the valuation date for the current year, the contribution is taken into account in determining the value of plan assets for the current plan year. For plan years beginning after 2006, the contribution is taken into account in the amount of its present value as of the valuation date for the current plan year, determined using the plan's effective rate of interest for the preceding plan year. In addition, any required contribution for the current plan year is not taken into account in determining the value of plan assets. If a required contribution for the current plan year is made before the valuation date, the value of plan assets is reduced for interest on the contribution for the period from the time of

[29] In the case of a plan's first plan year, the ability to use a valuation date other than the first day of the plan year is determined by taking into account the number of participants the plan is reasonably expected to have on each day during that first plan year.

contribution to the valuation date, determined using the plan's effective rate of interest for the preceding plan year.

Timing rules for contributions

As under present law, the due date for the payment of a minimum required contribution for a plan year is 8-½ months after the end of the plan year. Any payment made after the valuation date for the plan year must be increased by interest at the plan's effective rate of interest for the plan year for the period from the valuation date to the payment date. Similar to present-law rules, quarterly contributions must be made during a plan year if the plan had a funding shortfall for the preceding plan year (that is, if the value of the plan's assets, reduced by the funding standard carryover balance and prefunding balance, was less than the plan's funding target for the preceding plan year).[30]

Excise tax on failure to make minimum required contributions

The proposal retains the present-law rules under which an employer is generally subject to an excise tax if it fails to make minimum required contributions and fails to obtain a waiver from the IRS.[31] The excise tax is 10 percent of the aggregate unpaid minimum required contributions for all plan years remaining unpaid as of the end of any plan year. In addition, a tax of 100 percent may be imposed if any unpaid minimum required contributions remain unpaid after a certain period.

Conforming changes

The proposal makes various technical and conforming changes to reflect the new funding requirements.

Effective Date

The proposal is effective for plan years beginning after 2005.

[30] The proposal also retains the present-law rules under which the amount of any quarterly installment must be sufficient to cover any liquidity shortfall.

[31] The proposal retains the present-law rules under which a lien in favor of the plan with respect to property of the employer (and members of the employer's controlled group) arises in certain circumstances in which the employer fails to make required contributions.

B. Benefit Limitations Under Single-Employer Defined Benefit Pension Plans

1. Prohibition on shutdown benefits and other unpredictable contingent event benefits

Present Law

Under present law, defined benefit pension plans are not permitted to provide "layoff" benefits (i.e., severance benefits).[32] However, defined benefit pension plans may provide subsidized early retirement benefits, including early retirement window benefits.[33] A plan may also provide for unpredictable contingent event benefits, which are benefits that depend on contingencies that are not reliably and reasonably predictable, such as facility shutdowns or reductions in workforce. Under present law, unpredictable contingent event benefits generally are not taken into account for funding purposes until the event has occurred.

An amendment of a qualified retirement plan may not decrease the accrued benefit of a plan participant.[34] This restriction is sometimes referred to as the "anticutback" rule and applies to benefits that have already accrued. In general, an amendment may reduce the amount of future benefit accruals, provided that, in the case of a significant reduction in the rate of future benefit accrual, certain notice requirements are met.

For purposes of the anticutback rule, an amendment is also treated as reducing an accrued benefit if, with respect to benefits accrued before the amendment is adopted, the amendment has the effect of either (1) eliminating or reducing an early retirement benefit or a retirement-type subsidy, or (2) except as provided by Treasury regulations, eliminating an optional form of benefit.

Description of Proposal

Under the proposal, a single-employer plan may not provide benefits that are payable upon the occurrence of: (1) a plant shutdown; or (2) any other unpredictable contingent event. For this purpose, the term unpredictable contingent event means an event other than: (1) attainment of any age, performance of any service, receipt or derivation of any compensation, or the occurrence of death or disability; or (2) an event which is reasonably and reliably predictable (as determined by the Secretary of the Treasury).

Under the proposal, a plan does not fail to meet the requirements of the anti-cutback rule solely by reason of the adoption of a plan amendment necessary to meet the requirements of the proposal.

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[32] Treas. Reg. sec. 1.401-1(b)(1)(i).

[33] See, e.g., Treas. Reg. secs. 1.401(a)(4)-3(f)(4) and 1.411(a)-7(c).

[34] ERISA sec. 204(g); Code sec. 411(d)(6).

Effective Date

The proposal generally applies with respect to plant shutdowns, or other unpredictable contingent events, occurring after December 31, 2006.

In the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified before the date of enactment of the proposal, the proposal does not apply to plan years beginning before the earlier of: (1) the later of (a) the date on which the last collective bargaining agreement relating to the plan terminates (determined without regard to any extension thereof agreed to after the date of enactment), or (b) the first day of the first plan year to which the proposal would otherwise apply; or (2) January 1, 2009. For this purpose, any plan amendment made pursuant to a collective bargaining agreement relating to the plan that amends the plan solely to conform to any requirement under the proposal is not to be treated as a termination of the collective bargaining agreement.

2. Benefit limitations on underfunded plans

Present Law

In general

Under present law, various restrictions may apply to benefit increases and distributions from a defined benefit pension plan, depending on the funding status of the plan.

Limitation on certain benefit increases while funding waivers in effect

Within limits, the IRS is permitted to waive all or a portion of the contributions required under the minimum funding standard for a plan year.[35] A waiver may be granted if the employer responsible for the contribution could not make the required contribution without temporary substantial business hardship for the employer (and members of the employer's controlled group) and if requiring the contribution would be adverse to the interests of plan participants in the aggregate.

If a funding waiver is in effect for a plan, subject to certain exceptions, no plan amendment may be adopted that increases the liabilities of the plan by reason of any increase in benefits, any change in the accrual of benefits, or any change in the rate at which benefits vest under the plan.[36]

[35] ERISA sec. 303; Code sec. 412(d).

[36] ERISA sec. 304(b)(1); Code sec. 412(f).

Security for certain plan amendments

In the case of a single-employer defined benefit pension plan, if a plan amendment increasing current liability is adopted and the plan's funded current liability percentage is less than 60 percent (taking into account the effect of the amendment, but disregarding any unamortized unfunded old liability), the employer and members of the employer's controlled group must provide security in favor of the plan.[37] The amount of security required is the excess of: (1) the lesser of (a) the amount by which the plan's assets are less than 60 percent of current liability, taking into account the benefit increase, or (b) the amount of the benefit increase and prior benefit increases after December 22, 1987, over (2) $10 million. The amendment is not effective until the security is provided.

The security must be in the form of a bond, cash, certain U.S. government obligations, or such other form as is satisfactory to the Secretary of the Treasury and the parties involved. The security is released after the funded liability of the plan reaches 60 percent.

Prohibition on benefit increases during bankruptcy

Subject to certain exceptions, if an employer maintaining a single-employer defined benefit pension plans is involved in bankruptcy proceedings, no plan amendment may be adopted that increases the liabilities of the plan by reason of any increase in benefits, any change in the accrual of benefits, or any change in the rate at which benefits vest under the plan.[38]

Restrictions on benefit payments due to liquidity shortfalls

In the case of a single-employer plan with a funded current liability percentage of less than 100 percent for the preceding plan year, estimated contributions for the current plan year must be made in quarterly installments during the current plan year. If quarterly contributions are required with respect to a plan, the amount of a quarterly installment must also be sufficient to cover any shortfall in the plan's liquid assets (a "liquidity shortfall"). In general, a plan has a liquidity shortfall for a quarter if the plan's liquid assets (such as cash and marketable securities) are less than a certain amount (generally determined by reference to disbursements from the plan in the preceding 12 months).

If a quarterly installment is less than the amount required to cover the plan's liquidity shortfall, limits apply to the benefits that can be paid from a plan during the period of underpayment. During that period, the plan may not make: (1) any payment in excess of the monthly amount paid under a single life annuity (plus any social security supplement provided under the plan) in the case of a participant or beneficiary whose annuity starting date occurs during the period; (2) any payment for the purchase of an irrevocable commitment from an

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[37] ERISA sec. 307; Code sec. 401(a)(29).

[38] ERISA sec. 204(i); Code sec. 401(a)(33).

insurer to pay benefits (e.g., an annuity contract); or (3) any other payment specified by the Secretary of the Treasury by regulations.[39]

Prohibition on reductions in accrued benefits

An amendment of a qualified retirement plan may not decrease the accrued benefit of a plan participant.[40] This restriction is sometimes referred to as the "anticutback" rule and applies to benefits that have already accrued. In general, an amendment may reduce the amount of future benefit accruals, provided that, in the case of a significant reduction in the rate of future benefit accrual, certain notice requirements are met.

For purposes of the anticutback rule, an amendment is also treated as reducing an accrued benefit if, with respect to benefits accrued before the amendment is adopted, the amendment has the effect of either (1) eliminating or reducing an early retirement benefit or a retirement-type subsidy, or (2) except as provided by Treasury regulations, eliminating an optional form of benefit.

Description of Proposal

In general

Under the proposal, in the case of an underfunded single-employer defined benefit pension plan, limitations may apply with respect to: (1) plan amendments increasing benefit liabilities; (2) certain forms of distribution; and (3) benefit accruals.

Limitations on plans less than 80-percent funded

Limitations on plan amendments increasing benefit liabilities

Certain plan amendments may not take effect during a plan year if the plan's funding target attainment percentage for the plan year: (1) is less than 80 percent; or (2) would be less than 80 percent taking into account the amendment.[41] In such a case, no amendment may take effect if it increases the liabilities of the plan by reason of any increase in benefits, the establishment of new benefits, any change in the rate of benefit accrual, or any change in the rate at which benefits vest under the plan.

The limitation ceases to apply with respect to any plan year, effective as of the first day of the plan year (or, if later, the effective date of the amendment), if the plan sponsor makes a

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[39] ERISA sec. 206(e); Code sec. 401(a)(32).

[40] ERISA sec. 204(g); Code sec. 411(d)(6).

[41] The term "funding target attainment percentage" is defined under the proposal's minimum funding rules for single-employer plans and means the ratio, expressed as a percentage, that the value of the plan's assets (as reduced by the plan's funding standard carryover balance and prefunding balance) bears to the plan's funding target for the year (i.e., the present value of liabilities under the plan).

contribution (in addition to any minimum required contribution for the plan year), equal to: (1) if the plan's funding target attainment percentage is less than 80 percent, the amount of the increase in the plan's funding target for the plan year attributable to the amendment; or (2) if the plan's funding target attainment percentage would be less than 80 percent taking into account the amendment, the amount sufficient to result in a funding target attainment percentage of 80 percent. In addition, the limitation does not apply to a plan for the first five years the plan (or a predecessor plan) is in effect.

Funding-based limitation on certain forms of distribution

If a plan's funding target attainment percentage is less than 80 percent for a plan year, the restrictions on distributions that apply during a period of a liquidity shortfall apply to the plan as of the valuation date for the plan year. Thus, the plan may not make: (1) any payment in excess of the monthly amount paid under a single life annuity (plus any social security supplement provided under the plan) in the case of a participant or beneficiary whose annuity starting date occurs during the period; (2) any payment for the purchase of an irrevocable commitment from an insurer to pay benefits (e.g., an annuity contract); or (3) any other payment specified by the Secretary of the Treasury by regulations.

Additional limitation on benefit accruals for plans less than 60-percent funded

If a plan's funding target attainment percentage is less than 60 percent for a plan year, all future benefit accruals under the plan must cease as of the valuation date for the plan year. However, this limitation does not apply to a plan for the first five years the plan (or a predecessor plan) is in effect.

Determining funding levels

Under the proposal, certain presumptions apply in determining whether limitations apply with respect to a plan, subject to certification of the plan's funding target attainment percentage by the plan's enrolled actuary. If a plan was subject to a limitation for the preceding year, the plan's funding target attainment percentage for the current year is presumed to be the same as the preceding year until the plan actuary certifies the plan's actual funding target attainment percentage for the current year. If (1) a plan was not subject to a limitation for the preceding year, but its funding target attainment percentage for the preceding year was not more than 10 percentage points greater than the threshold for a limitation, and (2) as of the first day of the fourth month of the current plan year, the plan actuary has not certified the plan's actual funding target attainment percentage for the current year, the plan's funding target attainment percentage is presumed to be reduced by 10 percentage points as of that day. As a result, the restriction applies until the actuary certifies the plan's actual funding target attainment percentage. In any other case, if the plan actuary has not certified the plan's actual funding target attainment percentage by the first day of the tenth month of the current plan year, for purposes of the limitations, the plan's funding target attainment percentage is conclusively presumed to be less than 60 percent and that day is deemed to be the valuation date for the current plan year.

Notice to participants

If a limitation applies with respect to a plan, the plan administrator must provide written notice to participants and beneficiaries that the plan has become subject to the restriction within 30 days after the limitation applies or at such other time determined by the Secretary of Labor. If the plan administrator fails to provide the required notice, the Secretary of Labor may impose a civil penalty of up to $1,000 a day from the time of the failure.

Anticutback relief

Under the proposal, a plan does not fail to meet the requirements of the anti-cutback rule solely by reason of the adoption of a plan amendment necessary to meet the requirements of the proposal.

Restoration of benefits

If limitations on distributions or accruals apply with respect to plan for a plan year (other than because of a presumption as to the plan's funding target attainment percentage) and the limitation ceases to apply for a subsequent year, the plan may provide for the resumption of such distributions or accruals only by means of the adoption of a plan amendment after the valuation date for the subsequent plan year.

Effective Date

The proposal generally applies with respect to plan years beginning after 2006.

In the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified before the date of enactment of the proposal, the proposal does not apply to plan years beginning before the earlier of: (1) the later of (a) the date on which the last collective bargaining agreement relating to the plan terminates (determined without regard to any extension thereof agreed to after the date of enactment, or (b) the first day of the first plan year to which the proposal would otherwise apply; or (2) January 1, 2009. For this purpose, any plan amendment made pursuant to a collective bargaining agreement relating to the plan that amends the plan solely to conform to any requirement under the proposal is not to be treated as a termination of the collective bargaining agreement.

C. Modification of Transition Rule to Pension Funding Requirements for Interstate Bus Company

Present Law

Defined benefit pension plans are required to meet certain minimum funding rules. In some cases, additional contributions are required if a single-employer defined benefit pension plan is underfunded. Additional contributions generally are not required in the case of a plan with a funded current liability percentage of at least 90 percent. A plan's funded current liability percentage is the value of plan assets as a percentage of current liability. In general, a plan's current liability means all liabilities to employees and their beneficiaries under the plan. In the case of a plan with a funded current liability percentage of less than 100 percent for the preceding plan year, estimated contributions for the current plan year must be made in quarterly installments during the current plan year.

The PBGC insures benefits under most single-employer defined benefit pension plans in the event the plan is terminated with insufficient assets to pay for plan benefits. The PBGC is funded in part by a flat-rate premium per plan participant, and a variable rate premium based on the amount of unfunded vested benefits under the plan. A specified interest rate and a specified mortality table apply in determining unfunded vested benefits for this purpose.

A special rule modifies the minimum funding requirements in the case of certain plans. The special rule applies in the case of plans that (1) were not required to pay a variable rate PBGC premium for the plan year beginning in 1996, (2) do not, in plan years beginning after 1995 and before 2009, merge with another plan (other than a plan sponsored by an employer that was a member of the controlled group of the employer in 1996), and (3) are sponsored by a company that is engaged primarily in interurban or interstate passenger bus service.

The special rule generally treats a plan to which it applies as having a funded current liability percentage of at least 90 percent for plan years beginning after 1996 and before 2004 if for such plan year the funded current liability percentage is at least 85 percent. If the funded current liability of the plan is less than 85 percent for any plan year beginning after 1996 and before 2004, the relief from the minimum funding requirements generally applies only if certain specified contributions are made.

For plan years beginning in 2004 and 2005, the funded current liability percentage of the plan is treated as at least 90 percent for purposes of determining the amount of required contributions (100 percent for purposes of determining whether quarterly contributions are required). As a result, for these years, additional contributions and quarterly contributions are not required with respect to the plan. In addition, for these years, the mortality table used under the plan is used in determining the amount of unfunded vested benefits under the plan for purposes of calculating PBGC variable rate premiums.

For plan years beginning after 2005 and before 2010, the funded current liability percentage generally will be deemed to be at least 90 percent if the actual funded current liability percentage is at least at certain specified levels. The relief from the minimum funding requirements generally applies for a plan year beginning in 2006, 2007, or 2008 only if

contributions to the plan for the plan year equal at least the expected increase in current liability due to benefits accruing during the plan year.

Description of Proposal

The proposal revises the special rule for a plan that is sponsored by a company engaged primarily in interurban or interstate passenger bus service and that meets the other requirements for the special rule under present law. Under the proposal, for purposes of the quarterly contributions requirement, the plan is treated as not having a funding shortfall for any plan year.[42] As a result, quarterly contributions are not required with respect to the plan. In addition, the mortality table used under the plan is used in determining: (1) any present value or making any computation under the minimum funding rules applicable to the plan; and (2) the amount of unfunded vested benefits under the plan for purposes of calculating PBGC variable rate premiums.

Effective Date

The proposal is effective for plan years beginning after 2005.

[42] The term "funding shortfall" is defined under the provisions of the proposal relating to minimum funding rules for single-employer plans and means: (1) the excess (if any) of the plan's funding target for the plan year (i.e., the present value of liabilities under the plan), over (2) the value of the plan's assets.

D. Treatment of Nonqualified Deferred Compensation Plan when Employer's Defined Benefit Plan is in At-Risk Status

Present Law

Amounts deferred under a nonqualified deferred compensation plan for all taxable years are currently includible in gross income to the extent not subject to a substantial risk of forfeiture and not previously included in gross income, unless certain requirements are satisfied.[43] For example, distributions from a nonqualified deferred compensation plan may be allowed only upon certain times and events. Rules also apply for the timing of elections. If the requirements are not satisfied, in addition to current income inclusion, interest at the underpayment rate plus one percentage point is imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or if later, when not subject to a substantial risk of forfeiture. The amount required to be included in income is also subject to a 20-percent additional tax.

In the case of assets set aside in a trust (or other arrangement) for purposes of paying nonqualified deferred compensation, such assets are treated as property transferred in connection with the performance of services under Code section 83 at the time set aside if such assets (or trust or other arrangement) are located outside of the United States or at the time transferred if such assets (or trust or other arrangement) are subsequently transferred outside of the United States. A transfer of property in connection with the performance of services under Code section 83 also occurs with respect to compensation deferred under a nonqualified deferred compensation plan if the plan provides that upon a change in the employer's financial health, assets will be restricted to the payment of nonqualified deferred compensation.

Description of Proposal

Under the proposal, if during any period in which a defined benefit pension plan of an employer is in at-risk status, assets are set aside (directly or indirectly) in a trust (or other arrangement as determined by the Secretary of the Treasury), or transferred to such a trust or other arrangement, for purposes of paying deferred compensation, such transferred assets are treated as property transferred in connection with the performance of services (whether or not such assets are available to satisfy the claims of general creditors) under Code section 83.

If a nonqualified deferred compensation plan of an employer provides that assets will be restricted to the provision of benefits under the plan in connection with the at-risk status (or other similar financial measure determined by the Secretary of Treasury) of any defined benefit pension plan of the employer, or assets are so restricted, such assets are treated as property transferred in connection with the performance of services (whether or not such assets are available to satisfy the claims of general creditors) under Code section 83.

Any subsequent increases in the value of, or any earnings with respect to, transferred or restricted assets are treated as additional transfers of property. Interest at the underpayment rate

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[43] Code section 409A.

plus one percentage point is imposed on the underpayments that would have occurred had the amounts been includible in income for the taxable year in which first deferred or, if later, the first taxable year not subject to a substantial risk of forfeiture. The amount required to be included in income is also subject to an additional 20-percent tax.

Effective Date

The proposal is effective on January 1, 2006.

II. FUNDING RULES FOR MULTIEMPLOYER DEFINED BENEFIT PLANS

A. Funding Rules for Multiemployer Defined Benefit Plans

Present Law

Multiemployer plans

A multiemployer plan is a plan to which more than one unrelated employer contributes, which is established pursuant to one or more collective bargaining agreements, and which meets such other requirements as specified by the Secretary of Labor. Multiemployer plans are governed by a board of trustees consisting of an equal number of employer and employee representatives. In general, the level of contributions to a multiemployer plan is specified in the applicable collective bargaining agreements, and the level of plan benefits is established by the plan trustees.

Defined benefit multiemployer plans are subject to the same general minimum funding rules as single-employer plans, except that different rules apply in some cases. For example, different amortization periods apply for some costs in the case of multiemployer plans. In addition, the deficit reduction contribution rules do not apply to multiemployer plans.

Funding standard account

As an administrative aid in the application of the funding requirements, a defined benefit pension plan is required to maintain a special account called a "funding standard account" to which specified charges and credits are made for each plan year, including a charge for normal cost and credits for contributions to the plan. Other credits or charges or credits may apply as a result of decreases or increases in past service liability as a result of plan amendments or experience gains or losses, gains or losses resulting from a change in actuarial assumptions, or a waiver of minimum required contributions.

If, as of the close of the plan year, charges to the funding standard account exceed credits to the account, then the excess is referred to as an "accumulated funding deficiency." For example, if the balance of charges to the funding standard account of a plan for a year would be $200,000 without any contributions, then a minimum contribution equal to that amount would be required to meet the minimum funding standard for the year to prevent an accumulated funding deficiency. If credits to the funding standard account exceed charges, a "credit balance" results. The amount of the credit balance, increased with interest, can be used to reduce future required contributions.

Funding methods and general concepts

In general

A defined benefit pension plan is required to use an acceptable actuarial cost method to determine the elements included in its funding standard account for a year. Generally, an actuarial cost method breaks up the cost of benefits under the plan into annual charges consisting

of two elements for each plan year. These elements are referred to as: (1) normal cost; and (2) supplemental cost.

Normal cost

The plan's normal cost for a plan year generally represents the cost of future benefits allocated to the year by the funding method used by the plan for current employees and, under some funding methods, for separated employees. Specifically, it is the amount actuarially determined that would be required as a contribution by the employer for the plan year in order to maintain the plan if the plan had been in effect from the beginning of service of the included employees and if the costs for prior years had been paid, and all assumptions as to interest, mortality, time of payment, etc., had been fulfilled.

Supplemental cost

The supplemental cost for a plan year is the cost of future benefits that would not be met by future normal costs, future employee contributions, or plan assets. The most common supplemental cost is that attributable to past service liability, which represents the cost of future benefits under the plan: (1) on the date the plan is first effective; or (2) on the date a plan amendment increasing plan benefits is first effective. Other supplemental costs may be attributable to net experience losses, changes in actuarial assumptions, and amounts necessary to make up funding deficiencies for which a waiver was obtained. Supplemental costs must be amortized (i.e., recognized for funding purposes) over a specified number of years, depending on the source.

Valuation of assets

For funding purposes, the actuarial value of plan assets may be used, rather than fair market value. The actuarial value of plan assets is the value determined under a reasonable actuarial valuation method that takes into account fair market value and is permitted under Treasury regulations. Any actuarial valuation method used must result in a value of plan assets that is not less than 80 percent of the fair market value of the assets and not more than 120 percent of the fair market value. In addition, if the valuation method uses average value of the plan assets, values may be used for a stated period not to exceed the five most recent plan years, including the current year.

Reasonableness of assumptions

In applying the funding rules, all costs, liabilities, interest rates, and other factors are required to be determined on the basis of actuarial assumptions and methods, each of which is reasonable (taking into account the experience of the plan and reasonable expectations), or which, in the aggregate, result in a total plan contribution equivalent to a contribution that would be obtained if each assumption and method were reasonable. In addition, the assumptions are required to offer the actuary's best estimate of anticipated experience under the plan.

Charges and credits to the funding standard account

In general

Under the minimum funding standard, the portion of the cost of a plan that is required to be paid for a particular year depends upon the nature of the cost. For example, the normal cost for a year is generally required to be funded currently. Other costs are spread (or amortized) over a period of years. In the case of a multiemployer plan, past service liability is amortized over 40 or 30 years depending on how the liability arose, experience gains and losses are amortized over 15 years, gains and losses from changes in actuarial assumptions are amortized over 30 years, and waived funding deficiencies are amortized over 15 years.

Normal cost

Each plan year, a plan's funding standard account is charged with the normal cost assigned to that year under the particular acceptable actuarial cost method adopted by the plan. The charge for normal cost will require an offsetting credit in the funding standard account. Usually, an employer contribution is required to create the credit. For example, if the normal cost for a plan year is $150,000, the funding standard account would be charged with that amount for the year. Assuming that there are no other credits in the account to offset the charge for normal cost, an employer contribution of $150,000 will be required for the year to avoid an accumulated funding deficiency.

Past service liability

There are three separate charges to the funding standard account one or more of which may apply to a multiemployer plan as the result of past service liabilities. In the case of a plan in existence on January 1, 1974, past service liability under the plan on the first day on which the plan was first subject to ERISA is amortized over 40 years. In the case of a plan which was not in existence on January 1, 1974, past service liability under the plan on the first day on which the plan was first subject to ERISA is amortized over 30 years. Past service liability due to plan amendments is amortized over 30 years.

Experience gains and losses

In determining plan funding under an actuarial cost method, a plan's actuary generally makes certain assumptions regarding the future experience of a plan. These assumptions typically involve rates of interest, mortality, disability, salary increases, and other factors affecting the value of assets and liabilities. The actuarial assumptions are required to be reasonable, as discussed below. If the plan's actual unfunded liabilities are less than those anticipated by the actuary on the basis of these assumptions, then the excess is an experience gain. If the actual unfunded liabilities are greater than those anticipated, then the difference is an experience loss. In the case of a multiemployer plan, experience gains and losses for a year are generally amortized over a 15-year period, resulting in credits or charges to the funding standard account.

Gains and losses from changes in assumptions

If the actuarial assumptions used for funding a plan are revised and, under the new assumptions, the accrued liability of a plan is less than the accrued liability computed under the previous assumptions, the decrease is a gain from changes in actuarial assumptions. If the new assumptions result in an increase in the accrued liability, the plan has a loss from changes in actuarial assumptions. The accrued liability of a plan is the actuarial present value of projected pension benefits under the plan that will not be funded by future contributions to meet normal cost or future employee contributions. In the case of a multiemployer plan, the gain or loss for a year from changes in actuarial assumptions is amortized over a period of 30 years, resulting in credits or charges to the funding standard account.

Funding waivers and amortization of waived funding deficiencies

Within limits, the Secretary of the Treasury is permitted to waive all or a portion of the contributions required under the minimum funding standard for the year (a "waived funding deficiency"). In the case of a multiemployer plan, a waiver may be granted if 10 percent or more of the number of employers contributing to the plan the employer could not make the required contribution without temporary substantial business hardship and if requiring the contribution would be adverse to the interests of plan participants in the aggregate. The minimum funding requirements may not be waived with respect to a multiemployer plan for more five out of any 15 consecutive years.

If a funding deficiency is waived, the waived amount is credited to the funding standard account. In the case of a multiemployer plan, the waived amount is then amortized over a period of 15 years, beginning with the year following the year in which the waiver is granted. Each year, the funding standard account is charged with the amortization amount for that year unless the plan becomes fully funded. In the case of a multiemployer plan, the interest rate used for purposes of determining the amortization on the waived amount is the rate determined under section 6621(b) of the Internal Revenue Code (relating to the Federal short-term rate).

Extension of amortization periods

Amortization periods may be extended for up to 10 years by the Secretary of the Treasury if the Secretary finds that the extension would carry out the purposes of ERISA and would provide adequate protection for participants under the plan and if such Secretary determines that the failure to permit such an extension would (1) result in a substantial risk to the voluntary continuation of the plan or a substantial curtailment of pension benefit levels or employee compensation, and (2) be adverse to the interests of plan participants in the aggregate. The interest rate with respect to extensions of amortization periods is the same as that used with respect to waived funding deficiencies.

Alternative funding standard account

As an alternative to applying the rules described above, a plan which uses the entry age normal cost method may satisfy an alternative minimum funding standard. Under the alternative, the minimum required contribution for the year is generally based on the amount necessary to bring the plan's assets up to the present value of accrued benefits, determine using

the actuarial assumptions that apply when a plan terminates. The alternative standard has been rarely used.

Description of Proposal

The proposal modifies the amortization periods applicable to multiemployer plans so that the amortization period for most charges is 15 years. Under the proposal, in the case of a plan which was not in existence on January 1, 1974, past service liability under the plan on the first day on which the plan is first subject to ERISA is amortized over 15 years (rather than 30); past service liability due to plan amendments is amortized over 15 years (rather than 30); and experience gains and losses resulting from a change in actuarial assumptions are amortized over 15 years (rather than 30). As under present law, experience gains and losses and waived funding deficiencies are amortized over 15 years. The new amortization periods do not apply to amounts being amortized under present-law amortization periods, that is, no recalculation of amortization schedules already in effect is required under the proposal. The proposal eliminates the alternative funding standard account.

The proposal provides that, upon application to the Secretary of the Treasury and subject to a notice requirement, such Secretary is to grant an extension of the amortization period with respect to any unfunded past service liability, investment loss, or experience loss. The extension may not exceed five years. This automatic extension does not apply unless the applicant demonstrates to the satisfaction of the Treasury Secretary that notice of the application has been provided to each affected party (as defined in ERISA section 4001(a)(21)).

The Secretary of the Treasury may grant an extension of such amortization periods for an additional five years beyond the automatic extension. The standard for determining whether such an extension may be granted are the same as under present law.

The proposal modifies the interest rate applicable to waived funding deficiencies and extensions of amortization periods so that it is the greater of (1) 150 percent of the Federal mid-term rate, or (2) the rate of interest used under the plan in determining costs.

Effective Date

The proposal is effective for plan years beginning after 2005.

B. Additional Funding Rules for Multiemployer Plans in Endangered or Critical Status

Present Law

Multiemployer defined benefit plans are subject to minimum funding rules similar to those applicable to single-employer plans.[44] Certain modifications to the single-employer plan funding rules apply to multiemployer plans that experience financial difficulties, referred to as "reorganization status." A plan is in reorganization status for a year if the contribution needed to balance the charges and credits to its funding standard account exceeds its "vested benefits charge."[45] The plan's vested benefits charge is generally the amount needed to amortize, in equal annual installments, unfunded vested benefits under the plan over: (1) 10 years in the case of obligations attributable to participants in pay status; and (2) 25 years in the case of obligations attributable to other participants. A plan in reorganization status is eligible for a special funding credit. In addition, a cap on year-to-year contribution increases and other relief is available to employers that continue to contribute to the plan.

Subject to certain requirements, a multiemployer plan in reorganization status may also be amended to reduce or eliminate accrued benefits in excess of the amount of benefits guaranteed by the PBGC.[46] In order for accrued benefits to be reduced, at least six months before the beginning of the plan year in which the amendment is adopted, notice must be given that the plan is in reorganization status and that, if contributions to the plan are not increased, accrued benefits will be reduced or an excise tax will be imposed on employers obligated to contribute to the plan. The notice must be provided to plan participants and beneficiaries, any employer who has an obligation to contribute to the plan, and any employee organization representing employees in the plan.

In the case of multiemployer plans, the PBGC insures plan insolvency, rather than plan termination. A plan is insolvent when its available resources are not sufficient to pay the plan benefits for the plan year in question, or when the sponsor of a plan in reorganization reasonably determines, taking into account the plan's recent and anticipated financial experience, that the plan's available resources will not be sufficient to pay benefits that come due in the next plan year.[47] An insolvent plan is required to reduce benefits to the level that can be covered by the plan's assets. However, benefits cannot be reduced below the level guaranteed by the PBGC.[48]

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[44] See section II.A., above, for a discussion of the minimum funding rules for multiemployer defined benefit plans.

[45] ERISA sec. 4241.

[46] ERISA sec. 4244A.

[47] ERISA sec. 4245.

[48] The limit of benefits that the PBGC guarantees under a multiemployer plan is the sum of 100 percent of the first $11 of monthly benefits and 75 percent of the next $33 of monthly benefits for each year of service. ERISA sec. 4022A(c).

If a multiemployer plans is insolvent, the PBGC guarantee is provided in the form of loans to the plan trustees. If the plan recovers from insolvency status, loans from the PBGC can be repaid. Plans in reorganization status are required to compare assets and liabilities to determine if the plan will become insolvent in the future.

Description of Proposal

In general

The proposal provides additional funding rules for multiemployer defined benefit plans that are in endangered or critical status. The present-law reorganization and insolvency rules continue to apply.

Within 90 days after the first day of the plan year, the plan actuary must certify to the Secretary of the Treasury whether or not the plan is in endangered or critical status for the plan year. If the certification is not made within this period, the plan is presumed to be in critical status until the actuary makes a contrary certification. In making the determination whether a plan is in endangered or critical status, the plan actuary must make projections for the current and succeeding plan years, using reasonable actuarial assumptions and methods, of the current value of plan assets and the present value of liabilities under the plan for the current year as of the beginning of the year, based on the actuarial statement for the preceding plan year. Any actuarial projection of plan assets must assume (1) reasonably anticipated employer and employee contributions for the current and succeeding plan years, assuming that the terms of one or more collective bargaining agreements pursuant to which the plain is maintained for the current plan year continue in effect for the succeeding plan years, or (2) that employer and employee contributions for the most recent plan year will continue indefinitely, but only if the plan actuary determines that there have been no significant demographic changes that would make continued application of such terms unreasonable.

If a plan is certified to be in endangered status or enters into critical status, notice must be provided within 30 days after the date of certification or entry to the participants and beneficiaries, the bargaining parties, the PBGC, the Secretary of Treasury and the Secretary of Labor.

Endangered status

A multiemployer plan is in endangered status if the plan's funding percentage for the plan year is less than 80 percent, or the plan has an accumulated funding deficiency for the plan year or is projected to have an accumulated funding deficiency in any of the six succeeding plan years (taking into account amortization extensions). A plan's funded percentage is the percentage of plan assets over accrued liability of the plan.

Within 240 days after a plan is certified as endangered, the plan sponsor must amend the plan to include a funding improvement plan approved by the bargaining parties. The funding improvement plan must provide that during the funding improvement period, the plan will have a certain required increase in the funded percentage and no accumulated funding deficiency for any plan year during the funding improvement period, taking into account amortization extensions (the "benchmarks"). The proposal requires that the plan's funded percentage increase

such that the difference between 100 percent and the plan's funded percentage for the last year of the funding improvement plan is not more than two-thirds of the difference between 100 percent and the plan's funded percentage for the first year of the funding improvement plan. Thus, the difference between 100 percent and the plan's funded percentage must be reduced by at least one-third during the funding improvement period. The funding improvement period is the 10-year period beginning on the earlier of (1) the second anniversary of the date of adoption of the funding improvement plan, or (2) the first day of the first plan year following the year (after certification of endangered status) in which the collective bargaining agreements covering at least 75 percent of active participants have expired.

Within 90 days after a plan is certified as endangered, the plan sponsor must provide to the bargaining parties alternative proposals for revised benefit structures, contribution structures, or both, reasonably expected to meet the requirements for the funding improvement plan. The proposals must include (1) at least one proposal for reductions in the amount of future benefit accruals necessary to achieve the benchmarks, assuming no amendments increasing contributions under the plan (other than amendments increasing contributions necessary to achieve the benchmarks after amendments have reduced future benefit accruals to the maximum extent permitted by law) and (2) at least one proposal for increases in contributions necessary to achieve the benchmarks assuming no amendments reducing future benefit accruals under the plan. Upon request of any bargaining party who employs at least five percent of the active participants, or represents as an employee organization at least five percent of the participants, the plan sponsor must provide information on other combinations of increases in contributions and reductions in future benefit accruals which would result in achieving the benchmarks. The plan sponsor may provide additional information as it deems appropriate.

Pending approval of the funding improvement plan, the plan sponsor must take all actions (consistent with the terms of the plan and present law) to ensure an increase in the plan's funded percentage and a postponement of an accumulated funding deficiency for at least one additional plan year. These actions include applications for extensions of amortization periods, use of the shortfall funding method in making funding standard account computations, amendments to the plan's benefit structure, reductions in future benefit accruals, and other reasonable actions.

In addition, pending approval of a funding improvement plan, the plan may not be amended to provide (1) a reduction in the level of contributions for participants who are not in pay status; (2) a suspension of contributions with respect to any period of service; or (3) any new or indirect exclusion of younger or newly hired employees from plan participation. Pending approval of a funding improvement plan, the plan cannot be amended to provide any additional optional forms of benefit. In addition, except in the case of amendments required as a condition of qualification under the Internal Revenue Code, no amendment may be adopted which increases liabilities of the plan by reason of any increase in benefits, any change in accrual of benefits, or any change in the rate at which benefits become nonforfeitable.

If no plan is adopted by the end of the 240-day period after a plan is certified as endangered, the plan enters into critical status as of the first day of the succeeding plan year. Notice must be provided to participants and beneficiaries, the bargaining parties, the PBGC, the Secretary of Treasury and the Secretary of Labor within 30 days after the plan enters critical status.

A summary of any funding improvement plan and any modifications, together with annual updates regarding the funding ratio of the plan, must be included in the plan's annual report and summary annual report.

Upon adoption of a funding improvement plan, the plan may not be amended to be inconsistent with the funding improvement plan, or to increase future benefit accruals, unless the plan actuary certifies in advance, that after taking into account the proposed increase, the plan is reasonably expected to meet the benchmarks.

<u>Critical status</u>

There are several ways that a multiemployer plan can be in critical status for a plan year. A multiemployer plan is in critical status for a plan year if:

1. As of the beginning of the current plan year, the funded percentage of the plan is less than 65 percent and the sum of (A) the market value of plan assets, plus (B) the present value of reasonably anticipated employer and employee contributions for the current plan year and the six succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect) is less than the present value of all nonforfeitable benefits for all participants and beneficiaries projected to be payable under the plan during the plan year and the six succeeding plan years,

2. As of the beginning of the current plan year, the sum of (A) the market value of plan assets, plus (B) the present value of the reasonably anticipated employer and employee contributions for the current plan year and each of the four succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect) is less than the present value of all nonforfeitable benefits for all participants and beneficiaries projected to be payable under the plan during the current plan year and each of the four succeeding plan years,

3. As of the beginning of the plan year, the funded percentage of the plan is less than 65 percent and the plan has an accumulated funding deficiency for the current plan year or is projected to have an accumulated funding deficiency for any of the four succeeding plan years (taking into account any extension of amortization periods),

4. (A) The plan's normal cost, plus interest for the current plan year on the amount of unfunded benefit liabilities under the plan as of the last day of the preceding year, exceeds the present value (as of the beginning of the plan year) of the reasonably anticipated employer and employee contributions for the current plan year, (B) the present value (as of the beginning of the plan year) of nonforfeitable benefits of inactive participants is greater than the present value (as of the beginning of the current plan year) of nonforfeitable benefits of active participants, and (C) the plan is projected to have an accumulated funding deficiency for the current plan year or any of the four succeeding plan years, or

5. (A) The funded percentage of the plan is greater than 65 percent for the current plan year and (B) the plan is projected to have an accumulated funding deficiency during any of the succeeding three plan years.

As previously discussed, a plan is in critical status if the plan is in endangered status for the preceding plan year and the requirements applicable to endangered plans were not met with respect to the plan.

If a plan is in critical status for a plan year (and no rehabilitation plan is currently in effect for the plan year), the plan must be amended within 240 days after the plan enters critical status to include a rehabilitation plan. A plan is treated as entering into critical status as of the date that the plan is certified to be in critical status, is presumed to be in critical status because no certification is made, or enters into critical status because the requirements of endangered status are not satisfied. A rehabilitation plan must consist of (1) amendments to the plan providing for measures, agreed to by the bargaining parties, to increase contributions, reduce plan expenditures, or reduce future benefit accruals, or to take any combination of such actions, determined necessary to cause the plan to cease to be in critical status during the rehabilitation period, or (2) reasonable measures to forestall possible insolvency if the plan sponsor determines that upon exhaustion of all reasonable measures, the plan would not cease to be in critical status during the rehabilitation period. The rehabilitation period is the 10-year period beginning on the earlier of (1) the second anniversary of the date of adoption of the rehabilitation plan or (2) the first day of the first plan year following the year (after entry into critical status) in which the collective bargaining agreements covering at least 75 percent of active participants have expired. Any schedule including reductions in future benefit accruals forming part of a rehabilitation plan is applicable with respect to any group of active participants who are employed by any bargaining party in proportion to the extent to which increases in contributions under the schedule apply to such bargaining party.

Within 90 days after the date of entry into critical status the plan sponsor must propose to all bargaining parties a range of alternative schedules of increases in contributions and reductions in future benefit accruals that would carry out a rehabilitation plan. One schedule must show the reductions in future benefit accruals that would be necessary to cause the plan to cease to be in critical status if there were no further increases in rates of contributions to the plan. If the plan sponsor determines that the plan will not cease to be in critical status during the rehabilitation period unless the plan is amended to provide for an increase in contributions, one schedule must show the increases in contribution rates that would be necessary to cause the plan to cease to be in critical status if future benefit accruals were reduced to the maximum extent permitted by law and the rate of future benefit accruals did not exceed one percent per plan year. Upon request of any bargaining party who employs at least five percent of the active participants, or represents as an employee organization at least five percent of the participants, the plan sponsor must include among the proposed schedules such schedules of increases in contributions and reductions in future benefit accruals as may be specified by the bargaining parties.

Pending approval of a rehabilitation plan, the plan may not be amended to provide (1) a reduction in the level of contributions for participants who are not in pay status; (2) a suspension of contributions with respect to any period of service; or (3) any new or indirect exclusion of younger or newly hired employees from plan participation. Pending approval of a rehabilitation plan, the plan cannot be amended to provide any additional optional forms of benefit. In addition, pending approval of a rehabilitation plan, except in the case of amendments required as a condition of qualification under the Internal Revenue Code, no amendment may be adopted

which increases liabilities of the plan by reason of any increase in benefits, any change in accrual of benefits, or any change in the rate at which benefits become nonforfeitable.

Upon adoption of a rehabilitation plan, the plan may not be amended to be inconsistent with the rehabilitation plan or to increase future benefit accruals, unless the plan actuary certifies in advance, that after taking into account the proposed increase, the plan is reasonably expected to cease to be in critical status.

Upon the adoption of a schedule of increases in contributions or reduction in future benefits as part of a rehabilitation plan, the plan sponsor may, no more than once in any three-year period, amend the plan to update the schedule to adjust for any experience of the plan contrary to past actuarial assumptions. A summary of the rehabilitation plan and any modifications, together with annual updates regarding the funding ratio of the plan, must be included in the annual report and summary annual report for the plan year.

The failure of an employer to make contributions in compliance with the rehabilitation schedule may, at the discretion of the plan sponsor, be treated as a complete or partial withdrawal from the plan.

If the rehabilitation plan is not adopted within the 240-day period after entry into critical status, the plan must be amended to implement the schedule proposed by the plan sponsor that shows the reductions in future benefit accruals that would be necessary to cause the plan to cease to be in critical status if there were no further increases in rates of contributions to the plan.

Effective Date

The proposal is effective for plan years beginning after 2005.

C. Measures to Forestall Insolvency of Multiemployer Plans

Present Law

In the case of multiemployer plans, the PBGC insures plan insolvency, rather than plan termination. A plan is insolvent when its available resources are not sufficient to pay the plan benefits for the plan year in question, or when the sponsor of a plan in reorganization reasonably determines, taking into account the plan's recent and anticipated financial experience, that the plan's available resources will not be sufficient to pay benefits that come due in the next plan year.

In order to anticipate future insolvencies, at the end of the first plan year in which a plan is in reorganization and at least every three plans year thereafter, the plan sponsor must compare the value of plan assets for the plan year with the total amount of benefit payments made under the plan for the plan year.[49] Unless the plan sponsor determines that the value of plan assets exceeds three times the total amount of benefit payments, the plan sponsor must determine whether the plan will be insolvent for any of the next three plan years.

Description of Proposal

Under the proposal, unless the plan sponsor determines that the value of plan assets exceeds three times the total amount of benefit payments, the plan sponsor must determine whether the plan will be insolvent for any of the next five plan years. If the plan sponsor makes a determination that the plan will be insolvent for any of the next five plan years, the plan sponsor must make the comparison of plan assets and benefit payments under the plan at least annually until the plan sponsor makes a determination that the plan will not be insolvent in any of the next five plan years.

Effective Date

The proposal is effective with respect to determinations made in plan years beginning after 2005.

[49] ERISA sec. 4245(d)(1).

D. Withdrawal Liability Reforms

Present Law

Under ERISA, an employer which withdraws from a multiemployer plan in a complete or partial withdrawal is liable to the plan in the amount determined to be the employer's withdrawal liability.[50] In general, a "complete withdrawal" means the employer has permanently ceased operations under the plan or has permanently ceased to have an obligation to contribute.[51] In determining if there is a complete withdrawal, special rules apply in the case of the building and construction industry, the entertainment industry, and employers primarily engaged in the long and short haul trucking industry, the household goods moving industry, or the public warehousing industry. In the case of employers engaged in the long and short haul trucking industry, the household goods moving industry, or the public warehousing industry, a complete withdrawal occurs only if (1) an employer permanently ceases to have an obligation to contribute under the plan or permanently ceases all covered operations under the plan, and (2) the PBGC determines that the plan has suffered substantial damage to its contribution base as a result of such cessation, or the employer fails to furnish a bond or amount held in escrow in an amount equal to 50 percent of the withdrawal liability of the employer.[52]

A "partial withdrawal" generally occurs if, on the last day of a plan year, there is a 70-percent contribution decline for such plan year or there is a partial cessation of the employer's contribution obligation.[53] A partial cessation of the employer's obligation occurs if (1) the employer permanently ceases to have an obligation to contribute under one or more, but fewer than all collective bargaining agreements under which obligated to contribute, but the employer continues to perform work in the jurisdiction of the collective bargaining agreement or (2) an employer permanently ceases to have an obligation to contribute under the plan with respect to work performed at one or more, but fewer than all of its facilities, but continues to perform work at the facility of the type for which the obligation to contribute ceased.[54]

When an employer withdraws from a multiemployer plan, the plan sponsor is required to determine the amount of the employer's withdrawal liability, notify the employer of the amount of the withdrawal liability, and collect the amount of the withdrawal liability from the

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[50] ERISA sec. 4201.

[51] ERISA sec. 4203.

[52] ERISA sec. 4203(d).

[53] ERISA sec. 4205.

[54] ERISA sec. 4205(b)(2).

employer.[55] The employer's withdrawal liability generally is based on the extent of the plan's unfunded vested benefits for the plan years preceding the withdrawal.[56]

As soon as practical after an employer's complete or partial withdrawal, the plan sponsor must notify the employer of the amount of liability and schedule of payments and demand payment in accordance with the schedule.[57] In general, amounts are required to be paid over the period of years necessary to amortize the amounts in level annual payments.[58] Under a special rule, in cases in which the amortization period exceeds 20 years, the employer's liability is limited to the first 20 annual payments.[59]

ERISA section 4225 provides rules limiting or subordinating withdrawal liability in certain cases. The amount of unfunded vested benefits allocable to an employer is limited in the case of certain sales of all or substantially all of the employer's assets and in the case of an insolvent employer undergoing liquidation or dissolution. Other limitations on withdrawal liability also apply.

A multiemployer plan, other than a plan which primarily covers employees in the building and construction industry, may adopt a rule that an employer who withdraws from the plan is not subject to withdrawal liability if certain requirements are satisfied.[60] In general, the employer is not liable if the employer (1) first had an obligation to contribute to the plan after the date of enactment of the Multiemployer Pension Plan Amendments Act of 1980; (2) contributed to the plan for no more than the lesser of six plan years or the number of years required for vesting under the plan; (3) was required to make contributions to the plan for each year in an amount equal to less than two percent of all employer contributions for the year; and (4) never avoided withdrawal liability because of the special rule.

<u>Description of Proposal</u>

The proposal repeals the special rule relating to complete withdrawal of employers primarily engaged in the long and short haul trucking industry, the household goods moving industry, or the public warehousing industry. Under the proposal, the general rules for determining whether there is a complete withdrawal would apply.

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[55] ERISA sec. 4202.

[56] ERISA secs. 4209 and 4211.

[57] ERISA sec. 4219.

[58] The payments are determined under ERISA sec. 4219(c).

[59] ERISA sec. 4219(c)(1)(B).

[60] ERISA sec. 4210.

Under the proposal, there is a partial withdrawal for the plan year if an employer continues to perform work of the type for which contributions are made under the plan by means of individuals who are not employees of such employer covered by such plan.

The proposal repeals the present-law rule providing that in cases in which the withdrawal liability amortization period exceeds 20 years, the employer's liability is limited to the first 20 annual payments. Thus, under the proposal, the amortization period required is the period of years necessary to amortize the amounts in level annual payments (as determined under ERISA sec. 4219(c)).

The proposal repeals the limitations on withdrawal liability under ERISA section 4225. Thus, the withdrawal liability rules apply absent the special limiting rules.

The proposal allows plans which primarily cover employees in the building and construction industry to adopt the rule that an employer who withdrawals from the plan is not subject to withdrawal liability if certain requirements are satisfied.

Effective Date

The proposal repealing the special complete withdrawal rule for employers primarily engaged in the long and short haul trucking industry, the household goods moving industry, or the public warehousing industry is effective for cessations to have obligations to contribute to multiemployer plans and cessations of covered operations under such plans occurring on or after January 1, 2006.

The proposal relating to partial withdrawals is effective for work performed on or after January 1, 2006.

The proposal repealing the rule limiting an employer's liability to 20 annual payments is effective for withdrawals occurring on or after January 1, 2006.

The proposal repealing the limitations on withdrawal liability is effective for sales occurring on or after January 1, 2006.

The proposal allowing plans which primarily cover employees in the building and construction industry to adopt the rule that an employer who withdrawals from the plan is not subject to withdrawal liability if certain requirements are satisfied is effective for withdrawals occurring on or after January 1, 2006.

E. Removal of Restrictions with Respect to Procedures Applicable to Disputes Involving Withdrawal Liability

Present Law

Under ERISA, when an employer withdraws from a multiemployer plan, the employer is generally liable for its share of unfunded vested benefits, determined as of the date of withdrawal (generally referred to as the "withdrawal liability"). Whether and when a withdrawal has occurred and the amount of the withdrawal liability is determined by the plan sponsor. The plan sponsor's assessment of withdrawal liability is presumed correct unless the employer shows by a preponderance of the evidence that the plan sponsor's determination of withdrawal liability was unreasonable or clearly erroneous. A similar standard applies in the event the amount of the plan's unfunded vested benefits is challenged.

The first payment of withdrawal liability determined by the plan sponsor is generally due no later than 60 days after demand, even if the employer contests the determination of liability. Disputes between an employer and plan sponsor concerning withdrawal liability are resolved through arbitration, which can be initiated by either party. Even if the employer contests the determination, payments of withdrawal liability must be made by the employer until the arbitrator issues a final decision with respect to the determination submitted for arbitration.

For purposes of withdrawal liability, all trades or businesses under common control are treated as a single employer. In addition, the plan sponsor may disregard a transaction in order to assess withdrawal liability if the sponsor determines that the principal purpose of the transaction was to avoid or evade withdrawal liability. For example, if a subsidiary of a parent company is sold and the subsidiary then withdraws from a multiemployer plan, the plan sponsor may assess withdrawal liability as if the subsidiary were still part of the parent company's controlled group if the sponsor determines that a principal purpose of the sale of the subsidiary was to evade or avoid withdrawal liability.

In the case of an employer that receives a notification of withdrawal liability and demand for payment after October 31, 2003, a special rule may apply if a transaction is disregarded by a plan sponsor in determining that a withdrawal has occurred or that an employer is liable for withdrawal liability. If the transaction that is disregarded by the plan sponsor occurred before January 1, 1999, and at least five years before the date of the withdrawal, then (1) the determination by the plan sponsor that a principal purpose of the transaction was to evade or avoid withdrawal liability is not be presumed to be correct, (2) the plan sponsor, rather than the employer, has the burden to establish, by a preponderance of the evidence, the elements of the claim that a principal purpose of the transaction was to evade or avoid withdrawal liability, and (3) if an employer contests the plan sponsor's determination through an arbitration proceeding, or through a claim brought in a court of competent jurisdiction, the employer is not obligated to make any withdrawal liability payments until a final decision in the arbitration proceeding, or in court, upholds the plan sponsor's determination.

Description of Proposal

Under the proposal, if (1) a plan sponsor determines that a complete or partial withdrawal of an employer has occurred or an employer is liable for withdrawal liability payments with respect to the complete or partial withdrawal of an employer from the plan; (2) such determination is based in whole or in part on a finding by the plan sponsor that a principal purpose of any transaction that occurred at least five years (two years in the case of a small employer[61]) before the date of complete or partial withdrawal was to evade or avoid withdrawal liability; and (3) the employer contests the plan sponsor's determination with respect to withdrawal liability payments through an arbitration proceeding, or through a claim brought in a court of competent jurisdiction, the employer is not obligated to make the withdrawal liability payments until a final decision in the arbitration proceeding, or in court, upholds the plan sponsor's determination.

Effective Date

The proposal applies to any employer that receives a notification of withdrawal liability and demand for payment on or after the date of enactment.

[61] A small employer is an employer who, immediately before the transaction, employs no more than 500 employees, and is required to make contributions to the plan on behalf of not more than 250 employees.

III. OTHER INTEREST-RELATED PROVISIONS

A. Interest Rate Assumption for Determination of Lump-Sum Distributions

Present law

Accrued benefits under a defined benefit pension plan generally must be paid in the form of an annuity for the life of the participant unless the participant consents to a distribution in another form. Defined benefit pension plans generally provide that a participant may choose among other forms of benefit offered under the plan, such as a lump-sum distribution. These optional forms of benefit generally must be actuarially equivalent to the life annuity benefit payable to the participant.

A defined benefit pension plan must specify the actuarial assumptions that will be used in determining optional forms of benefit under the plan in a manner that precludes employer discretion in the assumptions to be used. For example, a plan may specify that a variable interest rate will be used in determining actuarial equivalent forms of benefit, but may not give the employer discretion to choose the interest rate.

Statutory assumptions must be used in determining the minimum value of certain optional forms of benefit, such as a lump sum.[62] That is, the lump sum payable under the plan may not be less than the amount of the lump sum that is actuarially equivalent to the life annuity payable to the participant, determined using the statutory assumptions. The statutory assumptions consist of an applicable mortality table (as published by the IRS) and an applicable interest rate.

The applicable interest rate is the annual interest rate on 30-year Treasury securities, determined as of the time that is permitted under regulations. The regulations provide various options for determining the interest rate to be used under the plan, such as the period for which the interest rate will remain constant ("stability period") and the use of averaging.

Description of Proposal

The proposal changes the mortality table and interest rate used to calculate the minimum value of lump sums payable from a defined benefit pension plan.

The mortality table that must be used for calculating lump sums is based on the mortality the table required for minimum funding purposes (i.e., the RP-2000 Combined Mortality Table, as published by the Society of Actuaries, as in effect on the date of enactment of the bill and revised from time to time) modified as appropriate by the Secretary of the Treasury. It is intended that the Secretary shall prescribe gender-neutral tables for use in determining minimum lump sums.

[62] ERISA sec. 205(g)(3); Code sec. 417(e)(3).

The proposal provides that minimum lump-sum values are to be calculated using the adjusted first, second, and third segment rates as applied under the funding rules, with certain modifications, for the month before the date of distribution or such other time as the Secretary of the Treasury may prescribe by regulation. The adjusted first, second, and third segment rates are derived from a corporate bond yield curve prescribed by the Secretary of the Treasury for such month which reflects the yields on investment grade corporate bonds with varying maturities (rather than a three-year weighted average, as under the minimum funding rules). Thus, the interest rate that applies depends upon how many years in the future a participant's annuity payment will be made. Typically, a higher interest applies for payments made further out in the future.

A transition rule applies for distributions in 2006 through 2009. For distributions in 2006 through 2009, lump-sum values are determined as the weighted average of two values: (1) the value of the lump sum determined under the methodology under present law (the "old" methodology); and (2) the value of the lump sum determined using the methodology applicable for 2006 and thereafter (the "new" methodology). For distributions in 2006, the weighting factor is 80 percent for the lump-sum value determined under the old methodology and 20 percent for the lump-sum determined under the new methodology. For distributions in 2007, the weighting factor is 60 percent for the lump-sum value determined under the old methodology and 40 percent for the lump-sum determined under the new methodology. For distributions in 2008, the weighting factor is 40 percent for the lump-sum value determined under the old methodology and 60 percent for the lump-sum determined under the new methodology. For distributions in 2009, the weighting factor is 20 percent for the lump-sum value determined under the old methodology and 80 percent for the lump-sum determined under the new methodology.

The proposal also provides that a plan amendment requiring the use of the prescribed table and interest rate will not result in a violation of the rule that accrued benefits may not be decreased by plan amendment.

Effective Date

The proposal is effective for distributions made in years beginning after 2005.

B. Interest Rate Assumption for Applying Benefit Limitations to Lump-Sum Distributions

Present Law

Annual benefits payable under a defined benefit pension plan generally may not exceed the lesser of (1) 100 percent of average compensation, or (2) $170,000 (for 2005).[63] The dollar limit generally applies to a benefit payable in the form of a straight life annuity. If the benefit is not in the form of a straight life annuity (e.g., a lump sum), the benefit generally is adjusted to an equivalent straight life annuity. For purposes of adjusting a benefit in a form that is subject to the minimum value rules, such as a lump-sum benefit, the interest rate used generally must be not less than the greater of: (1) the rate applicable in determining minimum lump sums, i.e., the interest rate on 30-year Treasury securities; or (2) the interest rate specified in the plan. In the case of plan years beginning in 2004 or 2005, the interest rate used must be not less than the greater of: (1) 5.5 percent; or (2) the interest rate specified in the plan.

Description of Proposal

Under the proposal, for purposes of adjusting a benefit in a form that is subject to the minimum value rules, such as a lump-sum benefit, the interest rate used generally must be not less than the greater of: (1) 5.5 percent; (2) the rate that provides a benefit of not more than 105 percent of the benefit that would be provided if the rate applicable in determining minimum lump sums were used; or (3) the interest rate specified in the plan.

Effective Date

The proposal is effective for distributions made in years beginning after 2005.

[63] Code sec. 415(b).

IV. IMPROVEMENTS IN PBGC GUARANTEE PROVISIONS

A. Increases in PBGC Premiums for Single-Employer Plans

Present Law

The PBGC

The minimum funding requirements permit an employer to fund defined benefit plan benefits over a period of time. Thus, it is possible that a plan may be terminated at a time when plan assets are not sufficient to provide all benefits accrued by employees under the plan. In order to protect plan participants from losing retirement benefits in such circumstances, the Pension Benefit Guaranty Corporation ("PBGC"), a corporation within the Department of Labor, was created in 1974 under ERISA to provide an insurance program for benefits under most defined benefit plans maintained by private employers.

Termination of single-employer defined benefit plans

An employer may voluntarily terminate a single-employer plan only in a standard termination or a distress termination. The PBGC may also involuntarily terminate a plan (that is, the termination is not voluntary on the part of the employer).

A standard termination is permitted only if plan assets are sufficient to cover benefit liabilities. If assets in a defined benefit plan are not sufficient to cover benefit liabilities, the employer may not terminate the plan unless the employer (and members of the employer's controlled group) meets one of four criteria of financial distress.[64]

The PBGC may institute proceedings to terminate a plan if it determines that the plan in question has not met the minimum funding standards, will be unable to pay benefits when due, has a substantial owner who has received a distribution greater than $10,000 (other than by reason of death) while the plan has unfunded nonforfeitable benefits, or may reasonably be expected to increase PBGC's long-run loss unreasonably. The PBGC must institute proceedings to terminate a plan if the plan is unable to pay benefits that are currently due.

Guaranteed benefits

When an underfunded plan terminates, the amount of benefits that the PBGC will pay depends on legal limits, asset allocation, and recovery on the PBGC's employer liability claim.

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[64] The four criteria for a distress termination are: (1) the contributing sponsor, and every member of the controlled group of which the sponsor is a member, is being liquidated in bankruptcy or any similar Federal law or other similar State insolvency proceedings; (2) the contributing sponsor and every member of the sponsor's controlled group is being reorganized in bankruptcy or similar State proceeding; (3) the PBGC determines that termination is necessary to allow the employer to pay its debts when due; or (4) the PBGC determines that termination is necessary to avoid unreasonably burdensome pension costs caused solely by a decline in the employer's work force.

The PBGC guarantee applies to "basic benefits." Basic benefits generally are benefits accrued before a plan terminates, including (1) benefits at normal retirement age; (2) most early retirement benefits; (3) disability benefits for disabilities that occurred before the plan was terminated; and (4) certain benefits for survivors of plan participants. Generally only that part of the retirement benefit that is payable in monthly installments (rather than, for example, lump-sum benefits payable to encourage early retirement) is guaranteed.[65]

Retirement benefits that begin before normal retirement age are guaranteed, provided they meet the other conditions of guarantee (such as that before the date the plan terminates, the participant had satisfied the conditions of the plan necessary to establish the right to receive the benefit other than application for the benefit). Contingent benefits (for example, subsidized early retirement benefits) are guaranteed only if the triggering event occurs before plan termination.

For plans terminating in 2005, the maximum guaranteed benefit for an individual retiring at age 65 is $3,698.86 per month or $44,386.32 per year.[66] The dollar limit is indexed annually for inflation. The guaranteed amount is reduced for benefits starting before age 65.

In the case of a plan or a plan amendment that has been in effect for less than five years before a plan termination, the amount guaranteed is phased in by 20 percent a year.[67]

PBGC premiums

In general

The PBGC is funded by assets in terminated plans, amounts recovered from employers who terminate underfunded plans, premiums paid with respect to covered plans, and investment earnings. All covered single-employer plans are required to pay a flat per-participant premium and underfunded plans are subject to an additional rate variable premium based on the level of underfunding. The amount of both the flat rate premium and the variable rate premium are set by statute; the premiums are not indexed for inflation.

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[65] ERISA sec. 4022(b) and (c).

[66] The PBGC generally pays the greater of the guaranteed benefit amount and the amount that was covered by plan assets when it terminated. Thus, depending on the amount of assets in the terminating plan, participants may receive more than the amount guaranteed by PBGC.

Special rules limit the guaranteed benefits of individuals who are substantial owners covered by a plans whose benefits have not been increased by reason of any plan amendment. A substantial owner generally is an individual who: (1) owns the entire interest in an unincorporated trade or business; (2) in the case of a partnership, is a partner who owns, directly or indirectly, more than 10 percent of either the capital interest or the profits interest in the partnership; (3) in the case of a corporation, owns, directly or indirectly, more than 10 percent in value of either the voting stock of the corporation or all the stock of the corporation; or (4) at any time within the preceding 60 months was a substantial owner under the plan. ERISA sec. 4022(b)(5).

[67] The phase in does not apply if the benefit is less than $20 per month.

Flat rate premiums

The annual flat rate per participant premium is $19 per participant.

Variable rate premiums

The variable rate premium is equal to $9 per $1,000 of unfunded vested benefits. "Unfunded vested benefits" is the amount which would be the unfunded current liability (as defined under the minimum funding rules) if only vested benefits were taken into account and if benefits were valued at the variable premium interest rate. No variable rate premium is imposed for a year if contributions to the plan for the prior year were at least equal to the full funding limit for that year.

In determining the amount of unfunded vested benefits, the interest rate used is generally 85 percent of the interest rate on 30 year Treasury securities for the month preceding the month in which the plan year begins (100 percent of the interest rate on 30 year Treasury securities for plan years beginning in 2002 and 2003). Under PFEA 2004, in determining the amount of unfunded vested benefits for PBGC variable rate premium purposes for plan years beginning after December 31, 2003, and before January 1, 2006, the interest rate used is 85 percent of the annual rate of interest determined by the Secretary of the Treasury on amounts invested conservatively in long term investment-grade corporate bonds for the month preceding the month in which the plan year begins.

Description of Proposal

Flat rate premiums

Beginning in 2006, the proposal phases in an increase of the flat rate premium to $30 as adjusted for years after 2006 based on increases in average wages as defined under the Social Security Act.[68] The rate of the phase-in depends on the funded status of the plan. In general, the flat rate premium for a single-employer plan is determined under the following table:

If the plan year begins in:	*The flat rate premium is:*
2006	$21.20
2007	$23.40
2008	$25.60
2009	$27.20
2010 and thereafter	$30, as adjusted starting in 2007 for increases in average wages

[68] In general, if the premium amount as indexed is not a multiple of $1, the amount is rounded to the nearest $1; if the amount is a multiple of $.50, the amount is rounded to the next highest dollar amount.

A faster phase-in schedule applies to plans with funding below a certain level. If the funding target percentage of a plan for the preceding plan year was less than 80 percent, then the flat rate premium is determined under the following table:

If the plan year begins in:	***The flat rate premium is:***
2006	$22.67
2007	$26.33
2008 and thereafter	$30, as adjusted starting in 2007 for increases in average wages

Under the proposal, the same flat rate premium will apply to all plans, regardless of funding status, in 2010 and thereafter.

Variable rate premium

The determination of unfunded vested benefits for purposes of the variable rate premium is modified to conform to the funding rules of the proposal. Thus, under the proposal, unfunded vested benefits are equal to the amount which would be the plan's funding shortfall for the year if plan assets were valued at fair market value and only vested benefits were taken into account.[69] In valuing unfunded vested benefits the interest rate is the first, second, and third segment rates which would be determined under the funding rules of the proposal, if the segment rates were based on the yields of corporate bond rates, rather than a three-year average of such rates. Under the proposal, deductible contributions are no longer limited by the full funding limit; thus, the rule providing that no variable rate premium is required if contributions for the prior plan year were at least equal to the full funding limit no longer applies under the proposal.

Effective Date

The proposal is effective for plan years beginning after December 31, 2005.

[69] For this purpose, the fair market value of plan assets is not reduced by the plan's prefunding balance and funding standard carryover balance.

V. DISCLOSURE

A. Defined Benefit Plan Funding Notices

Present Law

Defined benefit pension plans are generally required to meet certain minimum funding requirements. These requirements are designed to help ensure that such plans are adequately funded. In addition, the Pension Benefit Guaranty Corporation ("PBGC") guarantees benefits under defined benefit pension plans, subject to limits.

Certain notices must be provided to participants in a single-employer defined benefit pension plan relating to the funding status of the plan. For example, ERISA requires an employer of a single-employer defined benefit plan to notify plan participants if the employer fails to make required contributions (unless a request for a funding waiver is pending).[70] In addition, in the case of an underfunded plan for which variable rate PBGC premiums are required, the plan administrator generally must notify plan participants of the plan's funding status and the limits on the PBGC benefit guarantee if the plan terminates while underfunded.[71]

Effective for plan years beginning after December 31, 2004, the plan administrator of a multiemployer plan must provide an annual funding notice to: (1) each participant and beneficiary; (2) each labor organization representing such participants or beneficiaries; (3) each employer that has an obligation to contribute under the plan; and (4) the PBGC.[72]

Such a notice must include: (1) identifying information, including the name of the plan, the address and phone number of the plan administrator and the plan's principal administrative officer, each plan sponsor's employer identification number, and the plan identification number; (2) a statement as to whether the plan's funded current liability percentage for the plan year to which the notice relates is at least 100 percent (and if not, a statement of the percentage); (3) a statement of the value of the plan's assets, the amount of benefit payments, and the ratio of the assets to the payments for the plan year to which the notice relates; (4) a summary of the rules governing insolvent multiemployer plans, including the limitations on benefit payments and any potential benefit reductions and suspensions (and the potential effects of such limitations, reductions, and suspensions on the plan); (5) a general description of the benefits under the plan which are eligible to be guaranteed by the PBGC and the limitations of the guarantee and circumstances in which such limitations apply; and (6) any additional information which the plan administrator elects to include to the extent it is not inconsistent with regulations prescribed by the Secretary of Labor.

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[70] ERISA sec. 101(d).

[71] ERISA sec. 4011. Multiemployer plans are not required to pay variable rate premiums.

[72] ERISA sec. 101(f).

The annual funding notice must be provided no later than two months after the deadline (including extensions) for filing the plan's annual report for the plan year to which the notice relates (i.e., generally nine or eleven months after the end of the plan year). The funding notice must be provided in a form and manner prescribed in regulations by the Secretary of Labor. Additionally, it must be written so as to be understood by the average plan participant and may be provided in written, electronic, or some other appropriate form to the extent that it is reasonably accessible to persons to whom the notice is required to be provided.

A plan administrator that fails to provide the required notice to a participant or beneficiary may be liable to the participant or beneficiary in the amount of up to $100 a day from the time of the failure and for such other relief as a court may deem proper.

Description of Proposal

The proposal expands the annual funding notice requirement that applies under present law to multiemployer plans, so that it applies also to single-employer plans and includes a summary of the rules governing termination of a single-employer plan. The proposal also changes the information that must be provided in the notice and accelerates the time when the notice must be provided.

The annual funding notice must include a statement of the ratio, as of the end of the plan year to which the notice relates, of: (1) the number of participants who are not in covered service under the plan and who are either in pay status or have vested benefits under the plan, to (2) the number of participants who are in covered service under the plan. The notice must also include a statement setting forth the funding policy of the plan and the asset allocation of investments under the plan (expressed as a percentage of total assets) as of the end of the plan year to which the notice relates.

Instead of a statement of the value of the plan's assets, the amount of benefit payments, and the ratio of the assets to the payments for the plan year to which the notice relates (as required under present law), the notice must provide, for the plan year to which the notice relates, a reasonable estimate of the value of the plan's assets, projected liabilities of the plan, and the ratio of these two amounts. For this purpose, a plan's projected liabilities are determined by projecting forward in a reasonable manner to the end of the plan year the liabilities to participants and beneficiaries as of the first day of the plan year, taking into account any significant events that occur during the plan year and that have a material effect on those liabilities, including any plan amendments in effect for the year.

In the case of a multiemployer plan that adopts a funding improvement plan, rehabilitation plan, or modification of either, during the plan year to which the notice relates, the notice must include a summary of the plan or modification.[73]

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[73] A proposal relating to the adoption of a funding improvement plan or rehabilitation plan by a multiemployer plan in endangered or critical status is described in Part II,B.

Under the proposal, the notice must be provided within 90 days of the end of the plan year to which it relates.

Effective Date

The proposal is effective for plan years beginning after December 31, 2005.

B. Additional Disclosure Requirements

Present Law

The plan administrator of a pension plan generally must file an annual return with the Secretary of the Treasury, an annual report with the Secretary of Labor, and certain information with the Pension Benefit Guaranty Corporation ("PBGC"). Form 5500, which consists of a primary form and various schedules, includes the information required to be filed with all three agencies. The plan administrator satisfies the reporting requirement with respect to each agency by filing the Form 5500 with the Department of Labor.

In the case of a defined benefit pension plan, the annual report must include an actuarial report. The actuarial report must include, for example, information as to the value of plan assets, the plan's accrued and current liabilities, expected disbursements from the plan for the year, plan contributions, the plan's actuarial cost method and actuarial assumptions, and amortization bases established in the year. The report must be signed by an actuary enrolled to practice before the IRS, Department of Labor and the PBGC.

The Form 5500 is due by the last day of the seventh month following the close of the plan year. The due date may be extended up to two and one-half months. Copies of filed Form 5500s are available for public examination at the U.S. Department of Labor.

A participant must be provided with a copy of the full annual report on written request. In addition, the plan administrator must automatically provide participants with a summary of the annual report within two months after the due date of the annual report (i.e., by the end of the ninth month after the end of the plan year unless an extension applies). The summary annual report must include a statement whether contributions were made to keep the plan funded in accordance with minimum funding requirements, or whether contributions were not made and the amount of the deficit. The current value of plan assets is also required to be disclosed. If an extension applies for the Form 5500, the summary annual report must be provided within two months after the extended due date. A plan administrator who fails to provide a summary annual report to a participant within 30 days of the participant making a request for the report may be liable to the participant for a civil penalty of up to $100 a day from the date of the failure.

Description of Proposal

Annual report

The proposal requires additional information to be provided in the annual report for a plan year. The proposal also accelerates the time when the summary annual report must be provided to participants and beneficiaries to within 15 business days after the due date for filing the annual report.

Under the proposal, the annual report must include the ratio of: (1) the number of participants who are not in covered service under the plan and who are either in pay status or have vested benefits under the plan, to (2) the number of participants who are in covered service under the plan. If the liabilities to participants or beneficiaries under the plan as of the end of a plan year consist (in whole or in part) of liabilities to the participants and beneficiaries borne by

two or more pension plans as of immediately before the plan year, the annual report must include the funded ratio of each of those plans as of immediately before the plan year and the funded ratio of the plan with respect to which the annual report is filed as of the end of the plan year. For this purpose, funded ratio means the ratio of: (1) the value of the plan's assets, to (2) the liabilities to participants or beneficiaries under the plan.

In the case of a multiemployer plan, the annual report for a plan year must include: (1) the number of employers obligated to contribute to the plan as of the end of the plan year; and (2) the number of participants under the plan on whose behalf no employer contributions have been made to the plan for the plan year. For this purpose, employer contribution means, in connection with a participant, a contribution made by an employer as an employer of that participant.

The proposal requires the actuarial statement filed with the annual return to include a statement explaining the actuarial assumptions and methods used in projecting future retirements and asset distributions under the plan.

Information regarding multiemployer plans

The proposal establishes new disclosure and reporting requirements with respect to multiemployer plans.

The administrator of a multiemployer plan must provide certain information to a participant, beneficiary, or employer having an obligation to contribute to the plan, who makes a written request. The administrator must provide: (1) a copy of any actuary report for any plan year, of which the plan has been in receipt for at least 30 days; and (2) a copy of any financial report prepared for the plan by any plan investment manager or advisor or other person who is a plan fiduciary, of which the plan has been in receipt for at least 30 days. An actuary or financial report must be provided to the requesting participant, beneficiary, or employer within 30 days after the request in a form and manner prescribed by the Secretary of Labor in regulations (to be issued within 90 days of enactment of the proposal).

In addition, the plan sponsor or administrator of a multiemployer plan must provide to any employer having an obligation to contribute to the plan, and which makes a written request, notice of: (1) the amount that would be the employer's withdrawal liability with respect to the plan if the employer withdrew from the plan on the last day of the year preceding the date of the request; and (2) the average increase, per plan participant, in accrued liabilities under the plan as of the end of the preceding plan year to participants on whose behalf no employer contributions are payable (or beneficiaries of such participants), which would be attributable to the withdrawal of the employer. For this purpose, employer contribution means, in connection with a participant, a contribution made by an employer as an employer of that participant. This notice must be provided to the requesting employer within 180 days after the request in a form and manner prescribed by the Secretary of Labor.

Any information required to be provided under the proposal may be provided in written, electronic, or other appropriate form to the extent such form is reasonably available to the persons to whom the information is required to be provided. A person is not entitled to receive

more than one copy of any actuary or financial report or more than one notice of withdrawal liability during any 12-month period. The plan administrator may make a reasonable charge to cover copying, mailing, and other costs of furnishing copies or notices under the proposal, subject to a maximum amount that may be prescribed by the Secretary of Labor.

In the case of a failure to comply with these requirements, the Secretary of Labor may assess a civil penalty of up to $1,000 per day for each failure to provide a notice. For this purpose, each violation with respect to a single participant or beneficiary is treated as a separate violation.

Effective Date

The proposal is effective for plan years beginning after December 31, 2005.

C. Notice to Participants and Beneficiaries of Section 4010 Filings with the PBGC

Present Law

In some cases, certain financial information with respect to the members of a controlled group and actuarial information with respect to plans maintained by members of the controlled group must be reported annually to the PBGC ("section 4010 information").[74] This reporting is required if: (1) the aggregate unfunded vested benefits (determined using the interest rate used in determining variable-rate premiums) as of the end of the preceding plan year under all plans maintained by members of the controlled group exceed $50 million (disregarding plans with no unfunded vested benefits); (2) the conditions for imposition of a lien (i.e., required contributions totaling more than $1 million have not been made) have occurred with respect to an underfunded plan maintained by a member of the controlled group; or (3) minimum funding waivers in excess of $1 million have been granted with respect to a plan maintained by any member of the controlled group and any portion of the waived amount is still outstanding. Information provided to the PBGC in accordance with these requirements is not available to the public.

The PBGC may assess a penalty for a failure to provide the required information in the amount of up to $1,000 a day for each day the failure continues.[75]

Description of Proposal

The proposal revises the circumstances in which reporting of section 4010 information is required. Specifically, instead of requiring reporting if the aggregate unfunded vested benefits as of the end of the preceding plan year under all plans maintained by members of the controlled group exceed $50 million, the proposal requires reporting if the aggregate funding targets attainment percentage with respect to a controlled group for the preceding plan year is less than 60 percent. The aggregate funding targets attainment percentage with respect to a controlled group for a plan year is the percentage, determined by taking into account all plans maintained by the members of the controlled group as of the end of the plan year, which: (1) the aggregate total of the values of plan assets, as of the end of the plan year, is of (2) the aggregate total of the funding targets of the plans, as of the end of the plan year, taking into account only vested benefits.

Under the proposal, any person submitting to the PBGC section 4010 information with respect to a plan must provide notice thereof within 90 days to participants and beneficiaries under the plan (and under all plans maintained by members of the controlled group of each contributing sponsor of the plan). The notice must set forth: (1) the number of single-employer plans insured by the PBGC that are in at-risk status and maintained by contributing sponsors of the plan (and by members of their controlled groups); (2) the value of the assets of each plan for the plan year, the funding target for the plan year, and the funding target attainment percentage

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[74] ERISA sec. 4010.

[75] ERISA sec. 4071.

of each plan for the plan year and (3) taking into account all single-employer plans maintained by the contributing sponsor and the members of its controlled group, the aggregate total values of the assets of the plans as of the end of the plan year, the aggregate total of the funding targets of the plans (taking into account only vested benefits), and the aggregate funding targets attainment percentage (as defined above) with respect to the contributing sponsor for the preceding plan year.

For purposes of the notice requirement, a plan is in "at-risk status" for a plan year if the plan's funding target attainment percentage for the preceding year was less than 60 percent. A plan's "funding target attainment percentage" means the ratio, expressed as a percentage, that the value of the plan's assets bears to the plan's funding target for the year (determined without regard to the special assumptions that apply to at-risk plans). A plan's funding target for a plan year is the present value of the liabilities to participants and beneficiaries under the plan.

Any notice required to be provided under the proposal may be provided in written, electronic, or other appropriate form to the extent such form is reasonably available to the persons to whom the information is required to be provided. A person is not entitled to receive more than one notice during any 12-month period. The person required to provide the notice may make a reasonable charge to cover copying, mailing, and other costs of furnishing the notice, subject to a maximum amount that may be prescribed by the PBGC.

The present-law authority of the PBGC to impose a penalty for failure to provide section 4010 information applies to a failure to provide the notice required under the proposal.

Effective Date

The proposal is effective for plan years beginning after 2006.

VI. PROHIBITED TRANSACTION EXEMPTION FOR THE PROVISION OF INVESTMENT ADVICE

Present Law

ERISA and the Code prohibit certain transactions between an employer-sponsored retirement plan and a disqualified person.[76] Disqualified persons include a fiduciary of the plan, a person providing services to the plan, and an employer with employees covered by the plan. For this purpose, a fiduciary includes any person who (1) exercises any authority or control respecting management or disposition of the plan's assets, (2) renders investment advice for a fee or other compensation with respect to any plan moneys or property, or has the authority or responsibility to do so, or (3) has any discretionary authority or responsibility in the administration of the plan.

Prohibited transactions include (1) the sale, exchange or leasing of property, (2) the lending of money or other extension of credit, (3) the furnishing of goods, services or facilities, (4) the transfer to, or use by or for the benefit of, the income or assets of the plan, (5) in the case of a fiduciary, any act that deals with the plan's income or assets for the fiduciary's own interest or account, and (6) the receipt by a fiduciary of any consideration for the fiduciary's own personal account from any party dealing with the plan in connection with a transaction involving the income or assets of the plan. However, certain transactions are exempt from prohibited transaction treatment, for example, certain loans to plan participants.

Under ERISA, the Secretary of Labor may assess a civil penalty against a person who engages in a prohibited transaction, other than a transaction with a plan covered by the prohibited transaction rules of the Code. The penalty may not exceed five percent of the amount involved in the transaction for each year or part of a year that the prohibited transaction continues. If the prohibited transaction is not corrected within 90 days after notice from the Secretary of Labor, the penalty may be up to 100 percent of the amount involved in the transaction. Under the Code, if a prohibited transaction occurs, the disqualified person who participates in the transaction is subject to a two-tier excise tax. The first level tax is 15 percent of the amount involved in the transaction. The second level tax is imposed if the prohibited transaction is not corrected within a certain period and is 100 percent of the amount involved.

Description of Proposal

The proposal adds a new category of prohibited transaction exemptions in connection with the provision of investment advice with respect to plan assets for a fee if: (1) the investment of plan assets is subject to the direction of plan participants or beneficiaries; (2) the

[76] ERISA sec. 406; Code sec. 4975. Under ERISA, the prohibited transaction rules apply to employer-sponsored retirement plans and welfare benefit plans. Under the Code, the prohibited transaction rules apply to qualified retirement plans and qualified retirement annuities, as well as individual retirement accounts and annuities, Archer MSAs, health savings accounts, and Coverdell education savings accounts. The prohibited transaction rules under ERISA and the Code generally do not apply to governmental plans or church plans.

advice is provided to the plan or a participant or beneficiary by a fiduciary adviser in connection with a sale, acquisition or holding of a security or other property (an "investment transaction") for purposes of investment of plan assets; and (3) certain other requirements are met. Under the proposal, the following are exempt from prohibited transaction treatment: (1) the provision of investment advice to the plan, participant or beneficiary; (2) an investment transaction (including any lending of money or other extension of credit associated with the investment transaction) pursuant to the advice; and (3) the direct or indirect receipt of fees or other compensation by a fiduciary adviser or an affiliate thereof (or any employee, agent or registered representative of the fiduciary adviser or an affiliate) in connection with the provision of the advice or an investment transaction pursuant to the advice.

Under the proposal, certain requirements must be met in order for the exemption to apply. When initially providing advice about a security or other property, the fiduciary adviser must provide to the recipient of the advice, on a reasonably contemporaneous basis, written notification of specified information (discussed below) as well as any disclosure required in connection with the investment transaction under any applicable securities laws. In addition, the investment transaction must occur solely at the direction of the recipient of the advice; the compensation received by the adviser and its affiliates in connection with the investment transaction must be reasonable; and the terms of the investment transaction must be at least as favorable as an arm's length transaction would be.

The written notification required to be provided by the fiduciary adviser must include information about the following: (1) all fees or compensation to be received by the adviser or any affiliate (including from a third party) in connection with the advice or the investment transaction; (2) any material affiliation or contractual relationship of the adviser or its affiliates in the security or other property involved in the investment transaction; (3) any limitation to be placed on the scope of the investment advice to be provided by the fiduciary adviser with respect to an investment transaction; (4) the types of services provided by the adviser in connection with the provision of investment advice; (5) the adviser's status as a fiduciary of the plan in connection with the provision of the advice; and (6) the ability of the recipient of the advice separately to arrange for the provision of advice by another adviser that could have no material affiliation with and receive no fees or other compensation in connection with the security or other property. In addition, in connection with the initial advice or subsequent advice, the required information must be maintained in currently accurate form and must be provided to a recipient of investment advice (without charge) at least annually and also when requested by the recipient of the advice or when there is a material change in the information. In the event of a material change in the information, currently accurate information must be provided to the recipient at a time reasonably contemporaneous to the change.

The written notification can be provided electronically. Any notification (or currently accurate information) must be written in a clear and conspicuous manner, calculated to be understood by the average plan participant, and be sufficiently accurate and comprehensive so as to reasonably apprise participants and beneficiaries of the required information. The Secretary of Labor is directed to issue a model form for the disclosure of fees and other compensation as required by the proposal.

The fiduciary adviser must maintain for at least six years any records necessary for determining whether the requirements for the prohibited transaction exemption were met. A prohibited transaction will not be considered to have occurred solely because records were lost or destroyed before the end of six years due to circumstances beyond the adviser's control.

For purposes of the proposal, "fiduciary adviser" is defined as a person who is a fiduciary of the plan by reason of the provision of investment advice to the plan, a participant or beneficiary and who is also: (1) registered as an investment adviser under the Investment Advisers Act of 1940 or under State laws; (2) a bank, a similar financial institution supervised by the United States or a State, or a savings association (as defined under the Federal Deposit Insurance Act), but only if the advice is provided through a trust department that is subject to periodic examination and review by Federal or State banking authorities; (3) an insurance company qualified to do business under State law; (4) registered as a broker or dealer under the Securities Exchange Act of 1934; (5) an affiliate of any of the preceding; or (6) an employee, agent or registered representative of any of the preceding who satisfies the requirements of applicable insurance, banking and securities laws relating to the provision of advice. "Affiliate" means an affiliated person as defined under section 2(a)(3) of the Investment Company Act of 1940. "Registered representative" means a person described in section 3(a)(18) of the Securities Exchange Act of 1934 or a person described in section 202(a)(17) of the Investment Advisers Act of 1940.

Subject to certain requirements, the employer or other person who is a plan fiduciary, other than a fiduciary adviser, is not treated as failing to meet the prohibited transaction requirements (or the fiduciary requirements of ERISA), solely by reason of the provision of investment advice as permitted under the proposal or of contracting for or otherwise arranging for the provision of the advice. This rule applies if: (1) the advice is provided under an arrangement between the employer or plan fiduciary and the fiduciary adviser for the provision of investment advice by the fiduciary adviser as permitted under the proposal; (2) the terms of the arrangement require compliance by the fiduciary adviser with the requirements of the proposal; and (3) the terms of the arrangement include a written acknowledgement by the fiduciary adviser that the fiduciary adviser is a plan fiduciary with respect to the provision of the advice. The fiduciary responsibility requirements of ERISA must also be met in connection with the provision of investment advice.

The proposal does not exempt the employer or a plan fiduciary from fiduciary responsibility under ERISA for the prudent selection and periodic review of a fiduciary adviser with whom the employer or plan fiduciary has arranged for the provision of investment advice. The employer or plan fiduciary does not have the duty to monitor the specific investment advice given by a fiduciary adviser.

The proposal also provides that nothing in the fiduciary responsibility provisions of ERISA is to be construed to preclude the use of plan assets to pay for reasonable expenses in providing investment advice.

Effective Date

The proposal is effective with respect to investment advice provided on or after January 1, 2006.

VII. DEDUCTION LIMITATIONS

A. Increase in Deduction Limits

Employer contributions to qualified retirement plans are deductible subject to certain limits. In general, the deduction limit depends on the kind of plan.

In the case of a defined benefit pension plan, the employer generally may deduct the greater of: (1) the amount necessary to satisfy the minimum funding requirement of the plan for the year; or (2) the amount of the plan's normal cost for the year plus the amount necessary to amortize certain unfunded liabilities over 10 years, but limited to the full funding limitation for the year. The full funding limitation is the excess, if any, of (1) the accrued liability of the plan (including normal cost), over (2) the lesser of (a) the market value of plan assets or (b) the actuarial value of plan assets. However, the full funding limit is not less than the excess, if any, of 90 percent of the plan's current liability (including the current liability normal cost) over the actuarial value of plan assets.

In order to encourage plan sponsors to fully fund defined benefit pension plans, the maximum amount otherwise deductible generally is not less than the plan's unfunded current liability.[77] In the case of a single-employer plan covered by the PBGC that terminates during the year, the maximum deductible amount is generally not less than the amount needed to make the plan assets sufficient to fund benefit liabilities as defined for purposes of the PBGC termination insurance program.

If an employer sponsors both a defined benefit pension plan and a defined contribution plan that covers some of the same employees, the total deduction for all plans for a plan year generally is limited to the greater of: (1) 25 percent of compensation; or (2) the contribution necessary to meet the minimum funding requirements of the defined benefit pension plan for the year (but not less than the amount of the plan's unfunded current liability).

Subject to certain exceptions, an employer that makes nondeductible contributions to a plan is subject to an excise tax equal to 10 percent of the amount of the nondeductible contributions for the year.

Description of Proposal

The proposal modifies the maximum deductible amount in the case of both single-employer defined benefit pension plans and multiemployer defined benefit pension plans.

In the case of a single-employer defined benefit pension plan, the maximum deductible amount is equal to the greater of:

[77] In the case of a plan with 100 or fewer participants, current liability for this purpose does not include the liability attributable to benefit increases for highly compensated individuals resulting from an amendment that is made or becomes effective, whichever is later, within the last two years.

1. the excess (if any) of the sum of 150 percent of the plan's funding target plus the normal cost for the plan year over the value of plan assets (determined as under the minimum funding rules), and

2. the excess (if any) of the sum of the plan's at-risk normal cost and at-risk funding target for the plan year over the value of the plan assets (determined as under the minimum funding rules). For this purpose, the at-risk funding target and at-risk normal cost are used regardless of whether the plan is in fact in at-risk status.

In determining the maximum deductible amount, plan assets are not reduced by any pre-funding balance or funding standard account carryover balance.

The proposal retains the present-law rule, that, in the case of a single-employer plan covered by the PBGC that terminates during the year, the maximum deductible amount is generally not less than the amount needed to make the plan assets sufficient to fund benefit liabilities as defined for purposes of the PBGC termination insurance program.

In the case of a multiemployer defined benefit plan, the maximum amount deductible is not less than 140 percent of current liability over the value of plan assets.

Effective Date

The proposal is effective for contributions for taxable years beginning after 2005.

B. Updating Deduction Rules for Combination of Plans

Present Law

Employer contributions to qualified retirement plans are deductible subject to certain limits. In general, separate deduction rules apply to defined benefit plans and defined contribution plans.

In the case of a defined benefit plan, the employer generally may deduct the amount necessary to satisfy the minimum funding requirement of the plan for the year. In addition, in order to encourage plan sponsors to fully fund defined benefit plans, the maximum amount otherwise deductible generally is not less than the plan's unfunded current liability. In the case of a plan that terminates during the year, the maximum deductible amount is generally not less than the amount needed to make the plan assets sufficient to fund benefit liabilities as defined for purposes of the PBGC termination insurance program. Contributions in excess of the full funding limit are generally not deductible.

In the case of a defined contribution plan, the employer generally may deduct contributions in an amount up to 25 percent of compensation paid or accrued during the employer's taxable year.

If an employer sponsors one or more defined benefit plans and one or more defined contribution plans that cover at least one of the same employees, an overall deduction limit applies to the total contributions to all plans for a plan year. The overall deduction limit generally is the greater of (1) 25 percent of compensation, or (2) the amount necessary to meet the minimum funding requirements of the defined benefit plan for the year (or the amount of either the plan's unfunded current liability or the plan's unfunded termination liability in the case of a terminating plan).

Under EGTRRA, elective deferrals are not subject to the limits on deductions and are not taken into account in applying the limits to other employer contributions. The combined deduction limit of 25 percent of compensation for defined benefit and defined contribution plans does not apply if the only amounts contributed to the defined contribution plan are elective deferrals.[78]

Subject to certain exceptions, an employer that makes nondeductible contributions to a plan is subject to an excise tax equal to 10 percent of the amount of the nondeductible contributions for the year. Certain contributions to a defined contribution plan that are nondeductible solely because of the overall deduction limit are disregarded in determining the amount of nondeductible contributions for purposes of the excise tax. Contributions that are disregarded are the greater of (1) the amount of contributions not in excess of six percent of the compensation of the employees covered by the defined contribution plan, or (2) the amount of matching contributions.

[78] Under the general EGTRRA sunset, this rule expires for plan years beginning after 2010.

Description of Proposal

Under the proposal, the overall limit on employer deductions for contributions to combinations of defined benefit and defined contribution plans applies to contributions to one or more defined contribution plans only to the extent that such contributions exceed six percent of compensation otherwise paid or accrued during the taxable year to the beneficiaries under the plans.

In addition, for purposes of determining the excise tax on nondeductible contributions, matching contributions to a defined contribution plan that are nondeductible solely because of the overall deduction limit are disregarded.

Effective Date

The proposal is effective for contributions for taxable years beginning after December 31, 2005.