

1. Treasury Issues Pension Funding Equity Act Guidance

Just two days (and the first business day) after President Bush signed the Pension Funding Equity Act (P.L. 108-218) into law, the Treasury Department on Monday, April 12 issued interim guidance on the new interest rate for pension funding and PBGC variable rate premium calculations (Notice 2004-34) and guidance on the procedures for eligible employers to elect deficit reduction contribution (DRC) relief (Announcement 2004-38). The guidance can be downloaded from the Treasury Department's Web site, at <http://www.treasury.gov/press/releases/js1320.htm>.

Funding Relief

The Pension Funding Equity Act (PFEA) amends the Internal Revenue Code and ERISA to replace the 30-year Treasury rate with a composite corporate bond rate for purposes of various pension funding rules for 2004 and 2005 plan years only. The PFEA directs the Treasury Department to develop a methodology (subject to certain guidelines) for determining the composite corporate bond rate, and to make the methodology and the rate publicly available.

Briefly, for 2004 and 2005 plan years, plan sponsors can use 90 to 100 percent (the "permitted range") of the 4-year weighted average composite corporate bond rate to determine their plans' current liability for purposes of the minimum full funding limitation under IRC section 412(c)(7)(E) and the DRC rules under IRC section 412(l). Plan sponsors also can use this rate to determine if they are required to make quarterly contributions for the 2004 plan year, but they must use 90 to 120 percent of the 4-year weighted average 30-year Treasury rate to determine the installment amount for 2004, if quarterly contributions are required.

Interestingly, the PFEA permits plans to choose between using the 4-year weighted average composite corporate bond rate and the 4-year weighted average 30-year Treasury rate to determine their plans' current liabilities for purposes of the IRC section 404 deduction rules. According to the conference agreement, the purpose of this rule is to ensure "the deduction limit is neither increased nor decreased so that employers are not penalized for fully funding their plans."

The 4-year weighted average composite corporate bond rates for plan years beginning in 2001 through April 2004, as published by the IRS in Notice 2004-34, are reproduced below.

Corporate Bond Weighted Average Interest Rates				
For Plan Years Beginning In:		Corporate Bond Weighted Average	Permissible Range	
Year	Month		90 Percent	100 Percent
2001	January	7.44	6.69	7.44
2001	February	7.44	6.69	7.44
2001	March	7.44	6.69	7.44
2001	April	7.43	6.68	7.43
2001	May	7.42	6.68	7.42

Corporate Bond Weighted Average Interest Rates				
For Plan Years Beginning In:		Corporate Bond Weighted Average	Permissible Range	
Year	Month		90 Percent	100 Percent
2001	June	7.42	6.68	7.42
2001	July	7.41	6.67	7.41
2001	August	7.40	6.66	7.40
2001	September	7.39	6.65	7.39
2001	October	7.37	6.64	7.37
2001	November	7.36	6.62	7.36
2001	December	7.34	6.61	7.34
2002	January	7.34	6.60	7.34
2002	February	7.33	6.60	7.33
2002	March	7.32	6.59	7.32
2002	April	7.32	6.58	7.32
2002	May	7.31	6.58	7.31
2002	June	7.30	6.57	7.30
2002	July	7.28	6.55	7.28
2002	August	7.26	6.53	7.26
2002	September	7.23	6.51	7.23
2002	October	7.20	6.48	7.20
2002	November	7.17	6.46	7.17
2002	December	7.14	6.43	7.14
2003	January	7.11	6.40	7.11
2003	February	7.07	6.36	7.07
2003	March	7.03	6.33	7.03
2003	April	6.98	6.29	6.98
2003	May	6.94	6.25	6.94
2003	June	6.87	6.19	6.87
2003	July	6.80	6.12	6.80
2003	August	6.75	6.08	6.75
2003	September	6.72	6.05	6.72
2003	October	6.68	6.01	6.68
2003	November	6.63	5.97	6.63
2003	December	6.59	5.93	6.59
2004	January	6.55	5.89	6.55
2004	February	6.50	5.85	6.50
2004	March	6.45	5.81	6.45
2004	April	6.40	5.76	6.40

PBGC Variable Rate Premium

Plan sponsors also can use 85 percent of the composite corporate bond rate (for the last month of the preceding plan year) to determine their plans' unfunded vested benefits under the PBGC's variable rate premium rules for 2004 and 2005 plan years. The monthly composite corporate bond rates for 2000 through March 2004, as published by the IRS in Notice 2004-34, are reproduced below.

Note that the PFEA does not change the interest rate requirements for valuing vested benefits for certain post-event and advance reporting requirements under ERISA sections 4043(a) and (b), or for the annual reporting requirements under ERISA section 4010. However, the PBGC recently issued Technical Update 04-2 to permit plan sponsors to continue using 100 percent (instead of 85 percent) of the 30-year Treasury yield to value vested benefits for certain of these requirements through May 31, 2004. Thus, in light of the PFEA, it is possible the PBGC will decide to allow plan sponsors to use the composite corporate bond rate for these purposes for the rest of 2004 and 2005.

Composite Corporate Bond Rates					
Month	2000	2001	2002	2003	2004
January	7.94	7.34	6.92	6.07	5.68
February	7.84	7.21	6.86	5.90	5.63
March	7.87	7.08	7.10	5.89	5.44
April	7.84	7.28	7.03	5.91	
May	8.27	7.28	6.99	5.42	
June	8.05	7.17	6.76	5.24	
July	7.93	7.13	6.74	5.77	
August	7.82	6.95	6.57	6.19	
September	7.87	7.05	6.27	5.95	
October	7.85	6.91	6.47	5.91	
November	7.82	6.82	6.30	5.86	
December	7.51	7.07	6.18	5.81	

Comments

As noted, Notice 2004-34 represents interim guidance on the PFEA interest rate. The Treasury Department is seeking comments on the method for determining the composite corporate bond rate, including comments on the indices the Department used and the weight given to each index. In determining the composite corporate bond rates beginning with September 2000 through the present, the Department used the following:

- (1) Citigroup High Grade Credit Index (AAA/AA, 10+ Years)
- (2) Merrill Lynch US Corporates AA-AAA Rated 10+ Years

(3) Lehman Brothers US A Long Credit

Comments are due by August 2, 2004. If the Treasury Department decides additional guidance is appropriate, it will not apply to plan years beginning before such additional guidance is issued. In the meantime, plan sponsors can rely on the interim guidance. (The IRS will publish the composite corporate bond rate, the 4-year weighted average composite corporate rate, and the permissible range on a monthly basis.)

Electing DRC Relief

Finally, Announcement 2004-38 explains the procedures for electing DRC relief as provided by the PFEA. The relief generally is available only to commercial passenger airlines and companies primarily engaged in producing or manufacturing a steel mill product or processing iron ore pellets.

2. Immediate Action May Preempt Selection in IRS Audit Initiative Targeting Large Retirement Plans

The IRS recently announced an audit initiative targeting retirement plans with at least 2,500 participants. Employers sponsoring such plans should immediately consider performing a compliance review to determine if qualification failures exist. If failures are found, consideration should be given to submitting an application under an IRS voluntary compliance program to voluntarily correct them. Doing so will preempt a costly IRS audit until the voluntary compliance process is complete. This program is in addition to the limited audit plan for selected industries begun on March 1st.

Employee Plans Team Audits

As a result of its recent restructuring, modernization, and reallocation of resource emphasis after the end of the GUST remedial amendment period, the IRS is launching a number of new audit initiatives. Among these are Employee Plans Team Audits (EPTAs), broad scope examinations that specifically target tax-qualified retirement plans with at least 2,500 participants. It is estimated that there currently are about 4,400 such plans in existence in the U.S.

According to IRS public statements, research conducted during its restructuring revealed that the large plan segment of the pension plan market had very little audit activity. While larger plans represent only about one percent of all tax-qualified plans, they include about 48 million participants and have combined assets of approximately \$2 trillion. In a pilot program that began in 2001, the IRS determined that when audits of these plans were conducted, significant issues were revealed. Based on these results, the IRS decided to make the pilot program a permanent feature of employee plan examinations in 2004.