

QUALIFIED PLANS 2005-1

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1. Final Comprehensive IRS Rules For 401(k)/(m) Plans

On December 29, 2004, the IRS published final comprehensive regulations under Code sections 401(k) and 401(m). 69 Fed. Reg. 78143. These new 401(k)/(m) regulations incorporate many of the provisions in the existing regulations, which were first published in 1991, and amended in 1994. In addition, they incorporate the numerous statutory changes that have been made to 401(k)/(m) plans after 1994, as well as IRS guidance related to the changes. (See [Qualified Plans 2003-7](#) for a discussion of the legislative changes and related IRS guidance incorporated into these regulations.)

The regulations are effective for plan years beginning on or after January 1, 2006. However, plan sponsors are permitted to apply the regulations to any plan year that ends after December 29, 2004, provided the plan applies *all* the rules in the final regulations for that plan year and all subsequent plan years. Thus, for example, an employer that would like to take advantage for the 2004 plan year of the ability to aggregate ESOP and non-ESOP portions of a plan for testing purposes will have to consider whether it can apply all the other testing rules as well.

A. Brief Summary of Key Changes

The final regulations include numerous changes that were introduced in the proposed regulations, which were issued on July 17, 2003. (See [Qualified Plans 2003-7](#) for a complete list of changes in the proposed regulations.) Even the more significant changes are quite technical, including those that –

- restrict the use of "targeted" QNECs and QMACs, such as QNECs allocated under the "bottom-up leveling" method, to satisfy the ADP/ACP tests;
- allow the aggregation of ESOPs and non-ESOPs for ADP/ACP testing purposes, making it easier for companies to take advantage of the ESOP dividend deduction;
- prohibit employers from pre-funding 401(k) deferrals and matching contributions to accelerate tax deductions (although the final regulations permit pre-funding for bona fide administrative considerations);

- add funeral expenses and expenses relating to the repair of damage to an employee's principal residence to the list of permissible safe harbor hardship distributions;
- disregard the recent narrowing of the definition of "dependent" in Code section 152 by the American Jobs Creation Act of 2004 for purposes of hardship distributions;
- expand the class of children whose medical expenses can result in a hardship distribution to include a non-custodial child;
- require that a plan may only make a plan-to-plan transfer of 401(k) accounts if it reasonably concludes that the accepting plan will continue to apply the 401(k) distribution restrictions to the transferred accounts;
- require the distribution of "gap period" earnings on excess contributions, although the final regulations provide that a plan may calculate earnings up to seven days before the date the excess contributions are distributed;
- extend the 401(k) rules for partnerships to sole proprietors;
- require that 401(k) contributions, which are nonforfeitable, generally must be taken into account for purposes of the section 411(a) vesting and service-crediting rules, such as whether 0% vested employer contributions can be deemed distributed and forfeited upon a participant's termination of employment, and whether a rehired participant's pre-break service may be disregarded upon his reemployment under the rule of parity;
- clarify that a change in status from employee to leased employee is not an event permitting distributions;
- clarify that a 401(k) plan utilizing the "early participation" rule under section 410(b)(4)(B) may rely on the ADP safe harbor solely for the portion of the plan that benefits participants with at least one year of service.

The final regulations are also notable because they do not –

- provide a general exception for flat dollar QNECs and QMACs, as requested by several commentators;
- drop the broad "anti-abuse" provision relating to testing methods, despite numerous requests by commentators;
- provide an exception for catch-up contributions that are recharacterized as matching contributions in the application of the ACP safe harbor, which requires that the rate of matching contributions must be the same for all participants; or
- provide much guidance on testing issues that arise in the context of mergers and acquisitions.

A chart listing all material changes made by the final regulations to existing guidance is enclosed.

B. Plan Amendments

Although the regulations permit some provisions to be incorporated by reference, it is likely that most 401(k) plans will have to be amended to reflect the new regulations. For example, many plans utilizing the ADP safe harbor include the non-safe harbor testing provisions, but limit their application to plan years that the employer decides not to rely on the safe harbor. This is no longer permissible – plans must expressly state whether they utilize safe harbor or non-safe harbor testing. In addition, plan documents will have to reflect the various testing options, as well as the fact that elective deferral contributions are taken into account in determining whether a participant is a "nonvested" participant under the rule of parity. It is also likely that employers will want to incorporate the various changes to the safe harbor hardship distribution provisions.

The IRS has not stated whether it intends to publish a model amendment, or whether plans must be amended before the regulations are implemented, *i.e.*, by the end of the 2005 plan year. However, in light of the fact that the new regulations may be applied for years ending after December 29, 2004, the IRS implies that operational compliance is sufficient.

2. Bush Administration Proposes to Revamp Single-Employer Defined Benefit Plan Funding and Related Rules

In 2003, the Bush Administration proposed replacing the 30-Year Treasury rate with a corporate bond "yield curve" and other far-reaching pension funding and disclosure reforms (Qualified Plans 2003-7). Since then, an inter-agency Administration task force has worked on a more comprehensive set of proposals to revamp the pension funding, disclosure and PBGC premium rules.

On January 10, the Bush Administration unveiled its long-awaited proposals. The Administration proposals would essentially scrap the current regular and deficit reduction contribution funding rules, and replace them with a simpler – but potentially much more onerous and volatile – minimum funding rule. The proposal would also impose significant benefit restrictions on certain underfunded plans and plans maintained by bankrupt sponsors, impose new notice requirements and significantly increase PBGC premiums for all plan sponsors.

Labor Secretary Chao, who announced the Administration's proposals, pointed to the current \$23.3 billion dollar deficit in the PBGC single-employer trust fund and current estimates that private defined benefit plans are underfunded by \$450 billion. She stated that "if nothing is done, the financial integrity of the federal insurance system will be compromised and the pension security of 34 million workers and retirees will be more at risk." According to the Administration's press release, the current funding rules do not ensure that pension plans are adequately funded, and underfunded plan terminations are threatening workers' retirement security and placing an increasing strain on the pension insurance system. A General Accounting Office report issued on January 25 echoed Chao's comments and retained the designation of PBGC's single employer program as "high risk." This has only increased the Administration's calls for pension funding reform.

As is typical, the Administration did not release legislative bill language, and many details of the proposals (including transition rules) are not yet available. The release of the Bush Administration's fiscal year 2006 budget proposals may contain additional details regarding the pension reform proposals. Some additional details were, however, released as part of a Power Point presentation used

to brief various business and other groups. A summary of our understanding of the Administration proposals follows.

A. New Funding and Deduction Rules

The funding standard account used to determine minimum funding requirements under current law would be eliminated and replaced by a simpler accounting device. For each plan year, the market value of a plan's assets would be compared to a measured value of the plan's liabilities. Any shortfall (the "funding target") would need to be covered by level contribution amounts spread over a period based on a 7-year calculation. One source has described that annual calculation as simply 1/7th of the funding target amount. Others, however, have described the proposal as a true 7-year amortization. A new funding target, and a new 7-year contribution amount, would be computed on a rolling basis for each succeeding plan year. Credit balances would no longer be allowed, *i.e.*, extra payments in one year would not directly satisfy the minimum required in the next year (although they would reduce the total shortfall in calculating the seven-year amount for the next year). Quarterly contribution requirements apparently would be retained.

For purposes of all funding calculations, the present value of plan liabilities would be measured using the most current mortality table published by the IRS and discount rates derived from a duration-matched "yield curve" of corporate bond rates. According to Administration officials, the interest rate under the yield curve would be based upon a spot rate averaged over 90 days (as proposed in the Administration's 2003 proposals). Significantly, the yield curve would also apply for purposes of computing lump-sum payments to participants and is likely to reduce payouts significantly.

Current law actuarial methods for smoothing assets and interest rates would be eliminated – creating another source of potential volatility. Other actuarial assumptions, such as retirement age and turnover, would depend on the creditworthiness of the plan's sponsoring employer, as rated by the three major credit rating agencies. Sponsors with an investment-grade credit rating (Baa or better) would be deemed to have "ongoing plans" and allowed to use assumptions traditionally considered appropriate for an ongoing pension plan. Sponsors with a junk bond credit status (below Baa) for 5 years or more would be required to use more conservative retirement and payout assumptions tailored to "at-

risk plans" – such "at-risk plans" would be required to assume that all employees take lump sums (if available under the plan) and retire at the earliest possible retirement age. Plans sponsored by employers that have been in junk bond status for less than 5 years would be treated as having a funding target between ongoing and at-risk. According to the Administration, this difference in treatment is based on the theory that "time spent in junk-bond status is a strong indicator of the likelihood of plan termination."

The proposal would increase deduction limits to permit the pre-funding of projected salary increases and include a "volatility cushion" to permit contributions up to 130% of the plan's funding target. According to Administration officials, the proposal would also permit all plan sponsors to make contributions up to the "at-risk" target – regardless of whether the sponsor falls under the "at-risk" definition.

B. Benefit Restrictions

The Administration proposal would also impose significant benefit restrictions on plans of bankrupt sponsors and certain underfunded plans. Depending upon the funding percentage of the plan and the credit status of the plan's sponsor, certain plans would be barred from increasing benefits and from paying lump sums. Plans maintained by bankrupt sponsors, and plans maintained by junk grade sponsors that are 60 percent funded or less, would be required to freeze accruals under the plan. Plans maintained by junk grade sponsors that are 60 percent funded or less would also be prohibited from preferentially funding executive compensation. It is not clear whether the five-year rule would apply for purposes of determining if the sponsor is in "junk grade" status.

C. PBGC Premium Structure

The proposal retains a two-tier premium structure. All plans would be charged a flat-rate premium, and underfunded plans would pay an additional risk-based premium. The flat-rate premium (currently \$19 per active participant) would be adjusted initially to \$30 per active participant (which is said to reflect inflation growth since the \$19 premium was set) and thereafter by annual increments indexed to wage growth. The risk-based premium would be based on a plan's underfunding relative to its funding target, and all underfunded plans would be required to pay some risk-based premium. The PBGC Board of Directors would be authorized to adjust the risk-based premium rates

periodically based on the PBGC financial condition and expected claims, and without the need for further legislation.

D. New Disclosure Rules and Filing Deadlines

The Administration proposal would:

- require plans to disclose in the summary annual report the plan's underfunding relative to its funding target for the current plan year and the two preceding years;
- make public certain financial information now filed by plan sponsors with the PBGC on a non-public basis as part of Form 4010;
- accelerate the deadlines for filing the plan's funding report (*i.e.*, a new-law analog to the actuarial statement now reported on Schedule B to IRS Form 5500) and for distributing information to participants.

E. Other Proposals

Briefing materials used by Administration officials also include references to proposals to:

- change the bankruptcy laws to permit the PBGC to perfect its lien against missed contributions while a plan sponsor is in bankruptcy;
- confirm the legality of cash balance and other hybrid forms of defined benefit plans;
- establish Employer Retirement Savings Accounts (ERSAs);
- increase worker access to investment education; and
- allow workers in defined contribution plans to diversify out of company stock after three years.

A number of these items have been included in prior Administration proposals.

F. Outlook

We expect heavy opposition to some of the Administration's funding and PBGC premium proposals from business groups generally and particularly from financially troubled companies and those with underfunded plans. Staff for the House and Senate tax-writing and labor committees are currently reviewing the Administration's proposals, and it is likely that they will hold hearings and introduce legislation in the next several months. House Education and the Workforce Chairman John Boehner (R-OH) and his staff have been working on a comprehensive pension reform bill, in conjunction with Education and the Workforce Subcommittee on Employer-Employee Relations Chairman Sam Johnson (R-TX). Senate Finance Committee Chairman Charles Grassley (R-IA) and Ranking Member Max Baucus (D-MT) are also likely to hold hearings and consider pension funding reforms, possibly as part of the Enron-related and other pension reforms approved by the Committee in the 108th Congress (S. 2424, the "National Employee Savings and Trust Equity Guarantee" Act or "NESTEG"). House Ways and Means Committee Chairman Bill Thomas (R-CA) and Senate Health, Education, Labor and Pensions Committee Chairman Michael Enzi (R-WY) are also expected to consider legislation in this area.

3. Final IRS Regulations Allow Elimination of DC Plan Distribution Options Without Advance Notice

On January 25, the IRS finalized, and made immediately effective, regulations that allow defined contribution plan sponsors to eliminate (or restrict) certain distribution options, without advance notice to participants. 70 Fed. Reg. 3475 (Jan. 25, 2005); Treas. Reg. § 1.411(d)-4, Q&A-2. The final regulations implement, without significant change, regulations proposed in July 2003 (Qualified Plans 2003-7).

As finalized, the regulations provide that a defined contribution plan sponsor may eliminate any optional form of distribution, without violating the anti-cutback rule, as long as the plan continues to offer a single-sum distribution form that is otherwise identical to any eliminated optional forms of benefit. In general, this means that the single-sum distribution form must be available on any date an eliminated form could have commenced, must be available in the same medium as the eliminated form

(e.g., cash), and may not impose any additional eligibility conditions.

Significantly, a sponsor can adopt an amendment eliminating optional distribution forms with respect to any distribution with an annuity starting date after the date the amendment is adopted, and need not provide any advance notice to participants of the amendment. Commentators had asked the IRS to soften the impact of this kind of amendment by allowing participants within 90 days of retirement to continue to elect the forms being eliminated, but the IRS rejected those requests.

A defined contribution plan sponsor considering the elimination of optional distribution forms should keep in mind that these regulations only provide relief from the anti-cutback rule. Accordingly, if the requirement in Code section 401(a)(11) that a plan offer a qualified joint and survivor annuity applies to the sponsor's defined contribution plan, or to a particular participant under the defined contribution plan, the plan sponsor could not eliminate the qualified joint and survivor annuity form. Of course, collective bargaining agreements may also restrict a company's flexibility.

Although a sponsor need not provide advance notice of an amendment eliminating optional distribution forms under a defined contribution plan, under ERISA, the sponsor would need to provide a summary of material modifications (or updated summary plan description) describing the amendment within 210 days after the end of the plan year in which the sponsor adopts the amendment.

4. Proposed IRS Regulations Implement Relative Value Disclosure Extension

The IRS just published proposed regulations revising the complex "relative value" disclosure regulations issued at the end of 2003 (Qualified Plans 2003-12). 70 Fed. Reg. 4058 (Jan. 28, 2005). For the most part, the proposed regulations implement, in regulation form, an effective date extension and other minor changes that the IRS announced in June 2004 (Ann. 2004-58; Qualified Plans 2004-7). However, the proposed regulations also include comments on "social security leveling" options that could affect many defined benefit plans.

We discuss the proposed regulations below.

Extension of Disclosure Deadline –

Consistent with Announcement 2004-58, the proposed regulations delay most new "relative value" disclosure requirements until 2006, *i.e.*, they will first apply to distributions with annuity starting dates after January 2006. Also, as under the Announcement, the proposed regulations carve out from the extension disclosures with respect to lump sums and other distribution forms that are subject to Code section 417(e)(3). The carve-out is for section 417(e)(3) distribution forms with an actuarial present value that is less than the actuarial present value of the applicable qualified joint and survivor annuity (QJSA) form.

The proposed regulations also include several clarifications regarding the extension and carve-out. In particular, they clarify that, for distributions ineligible for the extension, a plan must disclose the relative value of a QJSA, even if the plan provides a relative value disclosure that is not tailored to the participant's marital status. For example, if a plan provides a relative value disclosure to a married participant that is based on a single life annuity (the QJSA for an unmarried participant), the disclosure must include a comparison of the value of the married participant QJSA to the value of the single life annuity.

Also, the proposed regulations clarify that a plan may qualify for the extension even if there are minor differences between the value of an optional form and the value of the QJSA for a married participant, as long as the differences result from calculating the amount of an optional form based on a life annuity form, rather than on a married participant QJSA. Specifically (for purposes of qualifying for the extension), the actuarial present value of an optional form is treated as not being less than the actuarial present value of the QJSA form if (i) the actuarial present value of the optional form is not less than the actuarial present value of an unmarried participant QJSA, using Code section 417(e) interest and mortality assumptions, and (ii) the actuarial present value of an unmarried participant QJSA is not less than the actuarial present value of a married participant QJSA, using "reasonable actuarial assumptions."

Use of Reasonable Estimates – Consistent with the Announcement, the proposed regulations clarify that a plan administrator may use reasonable estimates when providing information on a "hypothetical participant" basis, under the same rules that apply for using reasonable estimates for participant-specific disclosures. Also, a plan administrator that generally provides information on

a "hypothetical participant" basis may choose to include certain items of participant-specific information in place of corresponding "hypothetical participant" information.

QJSA As Most Valuable Option – As forecast by the Announcement, the proposed regulations clarify that a plan that calculates a distribution using IRS-imposed assumptions will not violate the general requirement that no optional form may be more valuable than a QJSA. Thus, for example, a plan that calculates lump sums using Code section 417(e) assumptions will be protected from disqualification, even if the lump sums are more valuable than a QJSA.

Treatment of Social Security Leveling Options –

As noted above, the proposed regulations, like the Announcement, carve out from the disclosure deadline extension certain distributions that are subject to the present value calculation assumptions of Code section 417(e). Also, as in the Announcement, the proposed regulations include a laundry list of distribution options that are subject to Code section 417(e). Importantly, the proposed regulations add one distribution option to the laundry list: "social security level income options." This addition is important for several reasons.

- This language potentially excludes a group of distribution options from the extension that otherwise might have qualified for the extension.
- More importantly, this language means that plans must calculate social security level income option distributions using Code section 417(e) interest and mortality assumptions, rather than merely "reasonable" assumptions.
- This treatment triggers certain mandatory conversion assumptions in applying the section 415(b) limits to such options.

Although IRS officials have informally taken this position in the past, this is the first time that the IRS has formally taken a position on the application of Code section 417(e) requirements to social security level income options. We understand that many sponsors have taken a contrary position, based on a reasoned argument that section 417(e) does not apply where enhanced benefits (i) commence before the age when participants are entitled to unreduced old-age insurance benefits

under the Social Security Act, (ii) terminate before such age, and (iii) do not exceed such old-age insurance benefits (i.e., meet the requirements for a "social security supplement"). This position also is consistent with the IRS guidance that social security leveling options are considered to provide "substantially equal" periodic payments for purposes of applying eligible rollover distribution rules. See Treas. Reg. § 1.402(c)-1, Q&A-5(b).

Sponsors that do not use 417(e) assumptions in calculating social security leveling option distributions may be particularly interested in commenting on this aspect of the proposed regulations. Interested parties can submit written comments on the proposed regulations, and request a public hearing, through April 28.

5. JOBS Act Multinational Corporate Tax Break Covers Qualified Plan Funding

IRS Code Section 965, added by the American Jobs Creation Act of 2004 ("AJCA"), allows corporate taxpayers to repatriate dividends from their controlled foreign corporations on a tax-favored basis if a number of conditions and limitations are met. One requirement is that the dividends be invested in the United States pursuant to a domestic reinvestment plan that is approved by the taxpayer's president, chief executive officer, or comparable official before the payment of the dividend, and that is subsequently approved by the taxpayer's board of directors, management committee, executive committee, or similar body. The domestic reinvestment plan must provide for the investment of the dividend in the United States, including as a source for the funding of worker hiring and training, infrastructure, research and development, capital investments, or the financial stabilization of the corporation for the purposes of job retention or creation (other than as a payment for executive compensation).

Recent IRS Notice 2005-10 (Feb. 7 IRS Bulletin) provides considerable guidance on the complex new provision. Section 5.02 makes it clear that the provision for qualified expenditures for worker hiring, training, stabilization, etc., includes compensation and benefits and expressly (and broadly) covers funding a qualified (sec. 401(a)) plan, but not executive compensation. Section 5.05(b) states that, for example, taxpayers are not required to demonstrate the connection of the funding with new workers. However, it does require that the taxpayer's officers make a "reasonable

business judgment . . . that the resulting financial stabilization will be a positive factor in its ability to retain and create jobs in the United States." Interestingly, the provision does not distinguish between defined benefit and defined contribution plans.

Section 6.02 defines "executive compensation" for purposes of the express exclusion under Code section 965(b)(5), as follows:

Executive compensation is defined as compensation paid, directly or indirectly, by or on behalf of, the taxpayer, to any employee or former employee, in exchange for services (past, present, or future) performed for the taxpayer, if: (a) the individual is an employee who is subject to the requirements of section 16(a) of the Securities Exchange Act of 1934 with respect to the taxpayer; (b) the individual is an employee who would be subject to such requirements if the taxpayer were an issuer of equity securities referred to in such section; or (c) the individual is a former employee who was described in clauses (a) or (b) of this section 6.02 at the time of his or her severance from employment. A taxpayer may treat the ten employees who received the highest wages in the most recently ended calendar year as being the individuals described in clause (b) of this section 6.02.

Multinational companies and their tax advisors should consider the relief provided in the new law as it applies to qualified plan funding. The combination of tax-favored repatriation with tax-deductible funding may be a particularly attractive opportunity.

6. Proposed IRS Rules on Jobs Act Supplemental Wage Withholding

The IRS recently issued proposed regulations on supplemental wage withholding – the historically optional provision that allows employers to use a flat rate for income tax withholding on certain wage payments. 70 Fed. Reg. 767 (Jan. 5, 2005). The proposed regulations take into account the changes made by the American Jobs Creation Act of 2004 ("Jobs Act") and clarify the definition of "supplemental wages."

Prior to the Jobs Act, employers could treat "supplemental wages" as either regular wages (e.g.,

subject to withholding tables) or apply flat 25% income tax withholding (based on the third lowest rate of tax applicable under section 1(c) of the Code). The Jobs Act made supplemental withholding mandatory for supplemental wages that exceed \$1 million ("1M"), and increased the rate to 35%, the maximum individual tax rate. Accordingly, the proposed regulations would make the following changes for wages paid after December 31, 2004:

Wages of 1M or Less – If the supplemental wages paid by an "employer" are 1M or less for the taxable year, the rate is 25% (for 2005). This provision is optional. Therefore, as before, the employer can (1) aggregate the supplemental and regular wages and treat them as a single wage payment for the regular payroll period, or (2) use the flat rate if (i) income tax has been withheld from the employee's regular wages, and (ii) the supplemental wages are either not paid concurrently with regular wages, or paid concurrently but separately stated on the payroll records of the employer.

Wages Over 1M – To the extent that an employee's cumulative, year-to-date supplemental wages paid by the "employer" exceed 1M during a calendar year, they are now subject to the maximum individual tax rate (for 2005, 35%). This provision is mandatory, with no exceptions (e.g., it is irrelevant that the employee claimed exempt status on Form W-4). Failure to withhold this amount could result in the employer being liable for the shortfall, plus any related interest and penalties.

"Employer" as Controlled Group – For purposes of determining the 1M threshold, all supplemental payments made by the employer, an entity in the employer's controlled group (using 50% affiliation threshold), and a third-party agent count towards this limit. (It is unclear how third-party agents are going to track payments for purposes of this limit). A third-party agent can deem tax to have been withheld from regular wages (unless they are also the payroll agent for the regular wages), so they can use the flat 25% rate for all supplemental payments up to the 1M threshold.

Definition of Supplemental Wages – The proposed regulations more fully explain the definition of "supplemental wages" and "regular wages," based on a consolidation of existing guidance. Supplemental wages include any payment of wages by an employer that is not "regular wages," including (if paid in addition to regular wages) bonuses, overtime pay, commissions, back pay, reported tips, reimbursements or expense allowances, noncash fringe benefits, sick pay paid by a third party agent,

amounts includible in gross income under section 409A, and income recognized on the exercise of a nonqualified stock option. In addition, if an employer provides net bonuses at a specified level, the total of the net bonuses and the gross up for withholding are treated as supplemental wages (and, if they exceed 1M, will be subject to the 35% rate).

Regular wages are amounts paid by an employer for a payroll period either at a regular hourly rate or in a predetermined fixed amount. Wages that are based on factors other than the amount of time worked, such as commissions, tips, bonuses, are supplemental wages if they are paid in addition to regular wages. However, if an employee only receives one type of compensation from an employer during a calendar year, it will be treated as regular wages (even if it would normally be classified as supplemental). Presumably, payments of deferred compensation that would typically be supplemental are treated as regular wages after the employee retires (provided no other compensation is paid by the employer during the calendar year).

The final regulations are to be effective on the date published in the Federal Register. Because these rules are implementing the Jobs Act, which applies to payments made after December 31, 2004, employers should begin preparations to come into compliance as soon as possible. Comments are due by April 11.

7. Key 2005 Interest Rates for Calendar-Year DB Plans

The IRS has now announced all of the relevant interest rates for making key funding calculations under defined benefit plans.

A. Lump-Sum Cashout Rates

Plans are generally required to use GATT rates for 2005 plan years, although PBGC or other rates may still be used on an optional basis if more favorable to participants than GATT rates. Some plans use the PBGC rate in effect for January of the plan year or the GATT rate for the lookback month (December), although the regulations under Code section 417 provide many other options (for both PBGC rates and GATT 30-year Treasury rates). The applicable January 2005 rates are

PBGC rate (immediate annuities) – 3.00%

GATT rate (Dec. 2004) – 4.86%

B. Funding Rates

For purposes of certain minimum funding requirements, including the "Deficit Reduction Contribution" ("DRC") (Code sec. 412(l)), the law requires that the interest rate assumption fall within a "permissible range," based on the weighted average rates on amounts invested conservatively in long-term investment grade corporate bonds. IRS Notice 2005-9 (Jan. 24 [IRS Bulletin](#)) announces the following permissible range for 2005 calendar-year plan years.

90% - 100% of permissible range –

5.49% to 6.1%

The Notice also announces a somewhat lower permissible range, based on 30-year Treasury securities, which may be used for purposes of calculating the maximum deduction permitted under section 404.

C. Contributory Pension Plans

Code section 411(c) requires that contributory defined benefit plans credit interest on mandatory employee contributions at 120% of the Federal mid-term rate until the "determination date," and use GATT 30-year Treasury rates to determine present values from that date through the participant's normal retirement age. IRS has issued proposed rules in this area [Qualified Plans 96-1](#)). For 2005 calendar-year plans, 120% of the Federal mid-term rate (Rev. Rul. 2005-2, Table I) is 4.53%.

Enclosure