

Distributions Under the Pension Funding Equity Act of 2004

Notice 2004-78

This notice provides guidance regarding the actuarial assumptions that must be used for distributions with annuity starting dates occurring during plan years beginning in 2004 and 2005, to determine whether an amount payable under a defined benefit plan in a form that is subject to the minimum present value requirements of § 417(e)(3) of the Internal Revenue Code (“Code”) satisfies the requirements of § 415. This guidance reflects the change to the required interest rate rule of § 415(b)(2)(E)(ii) that was made by section 101(b)(4) of the Pension Funding Equity Act of 2004, Pub. L. 108-218 (“PFEA ’04”), the anti-cutback relief provided under section 101(c) of PFEA ’04, and the transition rule of section 101(d)(3).

Background

Section 415(b) of the Code provides limitations on the annual benefit under a defined benefit plan. Under § 415(b)(2)(B), if the benefit under the plan is payable in any form other than a straight life annuity, the determination as to whether the limitations of § 415(b) have been satisfied shall be made by adjusting such benefit so that it is equivalent to a straight life annuity.

Section 415(b)(2)(E) provides limitations on the actuarial assumptions that must be used to adjust a benefit payable in a form other than a straight life annuity to determine the annual benefit for this purpose. Prior to its amendment by PFEA ’04, § 415(b)(2)(E)(ii) provided that, for purposes of adjusting any benefit payable in a form that is subject to the minimum present value requirements of § 417(e)(3), the interest rate assumption must not be less than the greater of the applicable interest rate (as defined in § 417(e)(3)) or the rate specified in the plan. Section 415(b)(2)(E)(v) also prescribes a specific mortality table to be used for this purpose.

Rev. Rul. 98-1, 1998-1 C.B. 249, Q&A 8 provides that the actuarially equivalent straight life annuity for a benefit that is paid in a form that is subject to the minimum present value requirements of § 417(e)(3) is the greater of (1) the actuarially equivalent straight life annuity computed using the plan rate and plan mortality table or plan tabular factor specified in the plan for actuarial equivalence for the particular form of benefit payable and (2) the actuarially equivalent straight life annuity computed using the applicable interest rate and the applicable mortality table under § 417(e)(3).

Section 101(b)(4) of PFEA ’04 amended § 415(b)(2)(E)(ii) of the Code to provide that, for purposes of adjusting any benefit payable in a form that is subject to the minimum present value requirements of § 417(e)(3), the interest rate assumption must not be less than the greater of the applicable interest rate (as defined in § 417(e)(3)) or the rate specified in the plan, except that in the case of plan years beginning in 2004 or 2005, 5.5% is used in lieu of the applicable interest rate.

Section 101(c)(1) of PFEA ’04 provides that a plan that is amended pursuant to any change made by section 101 shall not fail

to meet the requirements of § 411(d)(6) of the Code and section 204(g) of the Employee Retirement Income Security Act of 1974 (“ERISA”), provided that the plan is amended on or before the last day of the first plan year beginning on or after January 1, 2006, and the plan is operated as though the amendment were in effect during the period beginning on the date the amendment is effective.

Section 101(d)(3) of PFEA '04 provides that, in the case of any participant or beneficiary receiving a distribution after December 31, 2003, and before January 1, 2005, the amount payable under any form of benefit subject to § 417(e)(3) of the Code and subject to any adjustment under § 415(b)(2)(B) shall not, solely by reason of the change to § 415(b)(2)(E)(ii) made by section 101(b)(4) of PFEA '04, be less than the amount that would have been so payable had the amount payable been determined using the applicable interest rate in effect on the last day of the last plan year beginning before January 1, 2004.

Questions and Answers

Q-1. What is the effect of section 101(b)(4) of PFEA '04?

A-1 Under the changes to § 415(b)(2) of the Code made by section 101(b)(4) of PFEA '04, if a defined benefit plan provides a benefit in a form that is subject to the minimum present value requirements of § 417(e)(3) of the Code in a plan year beginning in 2004 or 2005, the actuarially equivalent straight life annuity (that is used for demonstrating compliance with § 415) is the greater of the straight life annuity determined using the plan rate and plan mortality table and the straight life annuity determined using 5.5% and the applicable mortality table. Thus, for example, where a plan's interest rate is 5%, the applicable interest rate under § 417(e)(3) is 5.25%, and where the plan uses the applicable mortality table for determining actuarial equivalence, the effect of section 101(b)(4) of PFEA '04 would be to require the conversion of a single-sum distribution paid during the plan year beginning in 2004 to an equivalent straight life annuity using 5.5% rather than the applicable interest rate of 5.25% as under prior law. In such a case, to satisfy the limitations of § 415 of the Code, the maximum single-sum distribution for a participant who

is age 65 in 2004 would be \$1,866,645 calculated using 5.5% as required by section 101(b)(4) of PFEA '04 rather than \$1,905,638 calculated using 5.25% as required under prior law. However, higher distributions may be permitted in certain situations during 2004 pursuant to the transition rule of section 101(d)(3). See Q&A 4.

Q-2. What is the effective date of the changes made to § 415 of the Code by PFEA '04?

A-2. The changes to § 415 of the Code made by PFEA '04 are effective for plan years beginning on or after January 1, 2004. However, the changes do not apply to plans that terminated prior to April 10, 2004, the date of enactment of PFEA '04.

Q-3. What is the effect of the transition rule prescribed in section 101(d)(3) of PFEA '04?

A-3. The transition rule of section 101(d)(3) of PFEA '04 sets out a transition period during which a plan is permitted to pay a benefit subject to § 417(e)(3) of the Code in an amount that would be higher than what is otherwise permitted under § 415 as amended by PFEA '04. This higher amount is the lesser of the transition amount as calculated in Q&A-4 and the benefit calculated under the terms of the plan reflecting the limitations of § 415 disregarding the enactment of PFEA '04.

Q-4. How is the transition amount calculated?

A-4. The transition amount is the otherwise determined benefit that when converted to an actuarially equivalent straight life annuity determined using the plan rate and the plan mortality table is within the limitations of § 415 of the Code and when converted to an actuarially equivalent straight life annuity determined using the transition rate and the applicable mortality table is within the limitations of § 415. For this purpose, the transition rate is the applicable interest rate determined under the plan terms that are adopted and in effect on the last day of the last plan year beginning before January 1, 2004. In the example in Q&A-1, if the transition rate is 5.25%, when a plan provides a single-sum distribution, then the effect of the transition rule of § 101(d)(3) of PFEA '04 would be to allow the conversion of the single sum distribution to an equivalent straight life annuity using the transition rate of 5.25% (the greater of the transition rate and the

plan rate) rather than 5.5% which was required under § 101(b)(4) of PFEA '04. In such a case, the maximum single-sum distribution for a participant who is age 65 in 2004 would be \$1,905,638.

Q-5. What is the period during which the transition rule of section 101(d)(3) of PFEA '04 applies (transition period)?

A-5. The transition period begins on the first day of the first plan year beginning on or after January 1, 2004. The transition period ends on December 31, 2004. Thus, the transition rule of section 101(d)(3) of PFEA '04 applies to a distribution if the distribution has an annuity starting date that is on or after the first day of the first plan year beginning in 2004, but only if the annuity starting date is before December 31, 2004.

Q-6. Which plan amendments relating to sections 101(b)(4) and 101(d)(3) of PFEA '04 are treated as not violating the requirements of § 411(d)(6) of the Code and section 204(g) of ERISA pursuant to section 101(c) of PFEA '04?

A-6. Under section 101(c)(1) of PFEA '04, a plan that is amended pursuant to any change made by section 101 does not fail to meet the requirements of § 411(d)(6) of the Code and section 204(g) of ERISA, provided that the plan is amended on or before the last day of the first plan year beginning on or after January 1, 2006, and the plan is operated as though the amendment were in effect during the period beginning on the date the amendment is effective. With respect to plan amendments implementing the change to § 415 of the Code under section 101(b)(4) of PFEA '04 or the transition rule under section 101(d)(3) of PFEA '04, this relief applies to:

1. Plan amendments that implement the change to § 415 of the Code under section 101(b)(4) of PFEA '04 and the transition rule of section 101(d)(3) of PFEA '04 pursuant to the guidance set forth this notice;
2. Plan amendments that implement the change to § 415 of the Code under section 101(b)(4) of PFEA '04 but do not implement the transition rule of section 101(d)(3) of PFEA '04; and
3. Plan amendments that implement the change to § 415 of the Code under section 101(b)(4) of PFEA '04 and the

transition rule of section 101(d)(3) of PFEA '04 pursuant to a reasonable interpretation of that transition rule that is different than the guidance set forth in Q&A-3 through Q&A-5 but that results in a lower distribution amount than the amount that would have been distributed under that guidance.

Drafting Information

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