2001 Enrolled Actuaries Meeting

Blue Book

Questions to the PBGC

and Summary of Their Responses

March 2001

Summary of Discussions between the Enrolled Actuaries Program Committee and Staff of the Pension Benefit Guaranty Corporation on January 31 and February 21, 2001

The following pages set forth the questions posed to Staff of the Pension Benefit Guaranty Corporation at discussions on January 31 and February 21, 2001, with representatives of the Enrolled Actuaries Program Committee. Included also are summaries of the responses to those questions. The summary responses to the questions are intended to reflect as accurately as possible the statements made by the government representatives. However, those responses are merely the current views of the individuals and do not represent the positions of the Pension Benefit Guaranty Corporation or of any other governmental agency, and cannot be relied upon by any person for any purpose. Moreover, the PBGC has not in any way approved this booklet or reviewed it to determine whether the statements herein are accurate or complete.

The following representatives of the Enrolled Actuaries Program Committee took part in the discussions or the preparation of this booklet:

Bruce A. Cadenhead, William M. Mercer, Inc.
Curtis M. Cartolano, Hewitt Associates LLC
James G. Durfee, Towers Perrin
Marjorie R. Martin, Aon Consulting
Jay P. Rosenberg, Unifi Network, PricewaterhouseCoopers L.L.P.
Donald J. Segal, The Segal Company
Lawrence J. Sher, Unifi Network, PricewaterhouseCoopers L.L.P.
Kenneth A. Steiner, Watson Wyatt Worldwide

The following representatives of the Pension Benefit Guaranty Corporation took part in the discussions:

Stuart A. Sirkin, Director, Corporate Policy and Research Department
C. David Gustafson, Chief Policy Actuary
Jane D. Pacelli, Chief Research Actuary
Harold J. Ashner, Assistant General Counsel for Legislation and Regulations
Deborah C. Murphy, Staff Attorney

The Committee also thanks the practitioners who submitted questions for this booklet.

Copyright © 2001, Enrolled Actuaries Meeting

All rights reserved by Enrolled Actuaries Meeting. Permission is granted to print or otherwise reproduce a limited number of copies of the material on the diskette for personal, internal, classroom, or other instructional use, on the condition that the foregoing copyright notice is used so as to give reasonable notice of the copyright of the Enrolled Actuaries Meeting. This consent for free limited copying without prior consent of the Enrolled Actuaries Meeting does not extend to making copies for general distribution, for advertising or promotional purposes, for inclusion in new collective works, or for sale or resale.

INDEX

	Subject Matter	Questions
1.	Premiums	.1 - 10
2.	Standard Terminations	11 - 14
3.	Reportable Events	15 - 16
4.	Employer Reporting	17
5.	Penalty Policy	18
6.	Section 4044	19
7.	412(n) Liens	20

QUESTION 1

Premiums — Full Funding Limit Exemption (General)

How does the PBGC full funding limit exemption from the variable rate premium work in light of the changes the Retirement Protection Act of 1994 made to the full funding limitation under section 412(c)(7) of the Internal Revenue Code of 1986?

RESPONSE:

The Retirement Protection Act of 1994 ("RPA") added a "90% override" to the full funding limitation under section 412(c)(7) of the Internal Revenue Code of 1986 ("Code"). The 90% override provides that the full funding limitation is not less than the excess, if any, of 90% of the plan's current liability over the actuarial value of the plan's assets.

The 90% override does not require greater contributions for the PBGC full funding limit exemption ("PBGC FFL Exemption") than are required for the plan to be at the full funding limitation under Code section 412(c)(7) for funding purposes. Accordingly, a plan qualifies for the PBGC FFL Exemption for a plan year if the sum of contributions to the plan for the prior year (including any interest credited under the funding standard account) and any credit balance in the funding standard account (including interest to the end of the plan year) is not less than the full funding limitation under Code section 412(c)(7). For this purpose —

- the "full funding limitation under Code section 412(c)(7)" means the full funding limitation as calculated for minimum funding purposes, i.e., the sentence in the PBGC regulations providing that "[p]lan assets shall not be reduced by the amount of any credit balance in the plan's funding standard account" is inapplicable;

- there is no change in the PBGC rules (see 29 CFR § 4006.5(a)(5)) on rounding down contributions and on counting only contributions made by the earlier of the variable rate premium ("VRP") due date or the date when a premium filing is made claiming the PBGC FFL Exemption from the VRP.

PBGC Technical Update 00-4 (which can be found under "Legal Info" on the PBGC's web site) provides further detail. The Technical Update applies generally for PBGC premium purposes for plan years beginning after 1995.

This guidance has no effect on the vast majority of plans for which a VRP was paid before the Technical Update was issued. Based on the PBGC's analysis, there are only 100-200 plans for which a VRP might have been paid since 1996 solely as a result of applying the PBGC FFL Exemption in a manner inconsistent with Technical Update 00-4. The plan administrator of such a plan may apply for a refund through the PBGC's normal refund process. Refunds are subject to the six-year limitations period in ERISA section 4003(f)(5).

QUESTION 2

Premiums — Full Funding Limit Exemption (Use of Credit Balance)

A plan's full funding limitation under Code section 412(c)(7) for the year preceding the premium payment year is greater than zero but less than the amount of the credit balance in its funding standard account. The plan has made no contributions for the year preceding the premium payment year. Does the plan qualify for the PBGC FFL Exemption from the variable-rate premium?

RESPONSE:

Yes. As explained in PBGC Technical Update 00-4, a plan qualifies for the PBGC FFL Exemption for a plan year if the sum of contributions to the plan for the prior year and any credit balance in the funding standard account is not less than the full funding limitation under Code section 412(c)(7) for the prior year (all with appropriate interest adjustments). If the credit balance alone equals or exceeds the full funding limitation under Code section 412(c)(7) for the prior year, the plan qualifies for the PBGC FFL Exemption even if no contributions are made.

The Technical Update includes three examples but has no example in which the credit balance equals or exceeds the full funding limitation under Code section 412(c)(7). The following example addresses this situation. All amounts in the example include interest to the end of the plan year. The actuarial value of plan assets is assumed to equal the market value of plan assets.

Consider these relevant data for Plan X:

Assets	$29,000
Funding standard account credit balance	$ 2,000
Accrued liability	$28,000
90% of current liability of $30,000	$27,000

Plan X has a full funding limitation under Code section 412(c)(7) of $1,000, calculated as the excess of the plan's accrued liability of $28,000 over adjusted plan assets of $27,000 ($29,000 assets less $2,000 credit balance). The plan's 90% override full funding limitation is $0 because 90% of the plan's current liability ($27,000) does not exceed the plan's full assets of $29,000. Thus, the plan's full funding limitation is $1,000 (the greater of $1,000 or $0).

Plan X qualifies for the PBGC FFL exemption regardless of whether the employer contributes to the plan because the plan's credit balance ($2,000) exceeds its full funding limitation.

QUESTION 3

Premiums — Counting Months for Proration

Under an amendment to the premium regulations published by the PBGC on December 1, 2000 (at 65 FR 75160), plan administrators may pay prorated premiums for certain short plan years beginning after 2000, rather than paying a full year's premium and requesting a refund (or a credit against a future premium) as in the past. How are months computed for purposes of prorating the premium for a short plan year if the short year begins on a date other than the first of a calendar month?

RESPONSE:

The proration of the premium for a short plan year is based on the number of months in the short year, counting any partial month as a complete month. For example, if a terminating plan's last plan year runs from January 1 to July 11 (when all assets have been distributed in full satisfaction of plan benefits), the short plan year premium is seven-twelfths of what the full year's premium would have been (for the months January through July).

If a plan year begins on a day other than the first day of a calendar month, each "plan month" (*i.e.*, each month in the plan year) generally begins on the corresponding day of the later calendar month. For example, if the plan year begins on January 15, the second plan month begins on February 15, the third plan month on March 15, etc. Thus, if a short final year begins on January 15 and ends on July 11, there would be 6 (full or partial) months in the short year. (The last (partial) month, beginning June 15 and ending July 11, would count as a full month for purposes of prorating the premium.)

There are two special rules when a plan year begins at or near the end of a calendar month:

- If the plan year begins on the last day of a calendar month, successive plan months begin on the last day of successive calendar months. For example, if the plan year begins on November 30, successive plan months begin on December 31, January 31, the last day of February (the 28th or 29th), March 31, etc.

- If the plan year begins on the 29th or 30th of a calendar month other than February, the plan month beginning in February begins on the last day of February. For example, if the plan year begins on November 29, successive plan months begin on December 29, January 29, the last day of February (the 28th or 29th), March 29, etc. If the plan year begins on December 30, successive plan months begin on January 30, the last day of February (the 28th or 29th), March 30, April 30, etc.

Proration is permitted for a short first year of a new or newly covered plan, for a short year resulting from a change in the plan year, and for a short year resulting from distribution of plan assets pursuant to plan termination or trusteeship of a single-employer plan under ERISA section

4042. Note that for post-2000 plan years, plan administrators still have the alternative of paying a full year's premium for a short plan year and requesting a refund (or a credit against a future premium) calculated by the PBGC. The prorated premium is the same whether the plan administrator pays the prorated amount or pays for a full year and requests that the PBGC prorate the premium. The amendment to the premium regulations published on December 1, 2000, does not change the proration method.

QUESTION 4

Premiums — Change in Break-in-Service Rules

The change in the "participant" definition for plan years beginning after 2000 includes a change in the break-in-service rule used for premium purposes. What is the difference between the pre-2001 and post-2000 break-in-service rules?

RESPONSE:

For plan years beginning before 2001, a terminated non-vested individual ceases to be a participant for premium purposes when the individual incurs the greater of a one-year break in service under the plan or an absence of one full year. For plan years beginning after 2000, a terminated non-vested individual ceases to be a participant for premium purposes when the individual incurs a one-year break in service under the plan, regardless of the length of the individual's absence from employment. Thus, for post-2000 years, an individual may be dropped from the premium participant count earlier than under the pre-2001 definition.

For example, under the terms of a calendar-year plan, an individual might incur a one-year break in service before December 31, 2001 (the premium snapshot date for the 2002 premium) if the individual left employment on February 1, 2001, and did not perform 500 hours of service during a computation period ending on November 30, 2001, even though December 31, 2001, comes before the first anniversary of the individual's separation from employment. This individual would not be included in the participant count for 2002 under the new definition, although under the old definition the individual would have been counted as a participant for 2002 because the individual had not been absent for at least one year by December 31, 2001.

The equivalent of a "one-year break in service" for an elapsed-time plan would be a one-year period of severance, which typically coincides with the PBGC's pre-2001 break-in-service rule for determining the premium participant count. Thus, the change would typically have no impact on elapsed-time plans.

In many cases, a separated non-vested individual is dropped from the participant count before incurring a break in service because the plan provides for a "deemed $0 cashout" upon termination of employment. For a discussion of when a deemed cashout is considered to occur, see Q&A 9 in the 1998 PBGC Bluebook (look under "Informal Guidance" under "Business Info" on the PBGC's web site).

QUESTION 5

Premiums — Application of New Break-in-Service Rules

Under the definition of "participant" that is used for premium purposes for plan years beginning after 2000, a non-vested individual is dropped from the participant count for premium purposes when the individual incurs a one-year break in service under the plan. In an hours-of-service plan with a service computation period that coincides with the plan year, would a participant be dropped for the following year?

RESPONSE:

Under the new definition, if a non-vested individual incurs a break in service in a service computation period that coincides with the plan year, the PBGC would treat the individual as not being a participant for purposes of the following year's premium. For example, suppose a calendar-year hours-of-service plan requires more than 500 hours of service in a service computation period to avoid a break in service, and a non-vested participant in the plan earns 440 hours of service in the service computation period ending December 31, 2001. The PBGC would treat the individual as not being a participant for purposes of the plan's 2002 premium.

QUESTION 6

Premiums — Participant Count (New Plans)

The preamble to the final rule amending the definition of "participant," published December 1, 2000, says that "[o]ne result of this change is that newly created plans that do not grant past service credits will typically owe no flat-rate premium for their first year." If a newly created plan owes no premium at all for its first year, must the plan administrator nevertheless file premium forms for that year?

RESPONSE:

Yes. The plan administrator must make a premium filing certifying that the plan has no participants and owes no premium.

QUESTION 7

Premiums — Participant Count (1-ES Filers)

How are the early filing rules (relating to Form 1-ES) affected by the new definition of "participant" that applies to premium determinations for plan years beginning after 2000?

RESPONSE:

The early filing rules (relating to Form 1-ES) are based on participant counts for both the preceding year (to determine whether the plan has 500 or more participants and thus must file early, and to determine one of the "safe harbor" amounts for avoiding a penalty on any underpayment) and the current year (to determine the other "safe harbor" amount for avoiding a penalty). For the 2001 plan year, a plan must use the old definition of "participant" to determine whether early filing is required and to determine the "safe harbor" amount that is based on the prior year's participant count; but it must use the new definition to determine the "safe harbor" amount that is based on the current year's participant count. This is a complexity that arises for the 2001 plan year only.

QUESTION 8

Premiums — Participant Count (Comparison to Form 5500)

Why might a plan's Form 1 participant count for a year not match the plan's participant count on line 7 of Form 5500 for the prior year?

RESPONSE:

A plan's participant count for a plan year is typically determined as of the end of the prior plan year — the same date as the participant count for line 7 of the prior year's Form 5500. However, the participant counts on the two forms may not match. Here are some reasons why the two participant counts may not be the same.

- There is a difference in the break-in-service rules that apply to Form 1 and to line 7 of Form 5500. For purposes of line 7 of Form 5500, whether a non-vested individual is excluded from the participant count because of a break in service depends upon the plan language; under the provisions of most plans, the instructions for line 7 would require that a separated non-vested individual be counted as a participant until the individual has incurred five or more consecutive one-year breaks in service. For purposes of Form 1, the point at which a non-vested individual is excluded from the participant count because of a break in service depends on whether the plan year for which the participant count is being determined begins before 2001 or after 2000. For pre-2001 plan years, the test is whether the individual has incurred a break in service the greater of one year or the break-in-service period specified in the plan. For post-2000 plan years, the test is whether the individual has incurred a one-year break in service under the terms of the plan. See Q&A 4 for a more detailed discussion of break-in-service rules, including deemed distribution rules.

- An individual is excluded from the Form 1 participant count if an insurer has made an irrevocable commitment to provide all benefits with respect to the individual under the plan, even if the insurer has not yet provided to the individual a contract, policy, or certificate describing the benefits. If the plan administrator includes on line 7 of the Form 5500 individuals in this category who have not yet been issued a contract, policy, or certificate describing the benefits, the participant counts on the two forms may differ.

- In certain cases, such as mergers and spinoffs, participants are counted for purposes of the Form 1 as of the first day of the premium payment year — one day later than the date for counting participants for line 7 of the prior year's Form 5500. Counting participants as of different dates may result in different counts for purposes of the current year's Form 1 and line 7 of the prior year's Form 5500.

- For plan years beginning after 2000, individuals who are earning or retaining credited service but with respect to whom the plan has no benefit liabilities are not counted as

participants for premium purposes under the new definition of “participant” that applies to post-2000 years. But individuals who are earning or retaining credited service are considered to be participants for purposes of line 7 of the Form 5500, even if the plan has no benefit liabilities with respect to them.

QUESTION 9

Premiums — Floor Offset Plans

Under a floor-offset defined benefit plan, a participant's benefit is reduced by the benefit attributable to the participant's account balance in a separate defined contribution plan. Suppose that the benefit attributable to a floor-offset plan participant's defined contribution plan account balance completely offsets the participant's benefit under the floor-offset plan as of the premium snapshot date. In view of the change in the definition of "participant" for plan years beginning after 2000 (under which an individual is counted as a participant only if the plan has benefit liabilities with respect to the individual as of the snapshot date), must the plan pay premiums for the participant?

RESPONSE:

For administrative convenience, the PBGC will accept a simplified test for excluding the participant from the participant count in a floor-offset plan. Under the simplified test, the plan administrator would determine whether, under the terms of the floor-offset plan, a benefit would have been payable to the participant from the plan if, on the premium snapshot date, the participant had been fully vested, had terminated employment, and had been eligible for a distribution. If no benefit would have been payable, the participant may be excluded from the count. In the case of a deceased participant with one or more living beneficiaries not in pay status, the plan administrator would apply the same test to each beneficiary, assuming (for purposes of the test) that the beneficiary was eligible for a distribution on the snapshot date.

Whether a participant's benefit must be taken into account in computing unfunded vested benefits for purposes of the variable-rate premium depends on whether the plan has a current liability for vested benefits of the participant. A floor-offset plan has no vested current liability for a participant if and only if the offset equals or exceeds the gross vested benefit from the floor-offset plan at *every* decrement age for *every* type of decrement the actuary would use to value vested current liability. Similar rules would apply for a deceased participant with a living beneficiary not in pay status.

QUESTION 10

Premiums — Effective Date of New Plan

For a newly created calendar-year plan that is adopted 9/1, effective 1/1 of the same year, what date should be used as the plan's premium snapshot date for the premium for that plan year, and what date should be used as the beginning of that plan year for purposes of determining whether the year is a short first year for which the premium may be prorated?

RESPONSE:

The PBGC recognizes that there may be some ambiguity in its regulations regarding these points. Until the regulations are clarified, the plan administrator of a plan that is adopted with a retroactive effective date may claim either the earlier date or the later date as both (1) the beginning of the plan year for purposes of determining whether premium proration is available (and what the proration fraction is) and (2) the premium snapshot date. The same date should be used for both purposes (1) and (2). Thus, for the plan described in the question, either 9/1 or 1/1 could be used.

For plan years beginning before 2001, it is generally advantageous to the plan to use the later date (*e.g.*, 9/1 for the plan described in the question) because of the ability to get a *pro rata* refund. For post-2000 plan years, as a result of the change in the PBGC's "participant" definition, either the earlier or the later date may be advantageous, depending on whether or not the plan grants past service credit (*i.e.*, credit for service before the effective date). If the plan grants no past service credit, it will virtually always be advantageous to use the effective date (*e.g.*, 1/1 for the plan described in the question) as the snapshot date and the beginning of the plan year. This is because there will virtually always be no benefit liabilities on that date, and thus (under the new "participant" definition) no participants for whom a flat-rate premium would be owed. (This would also mean that there would be no variable-rate premium either.) If the plan grants past service credit, it may be advantageous to use the later date, in order to be able to prorate the premium.

QUESTION 11

Standard Terminations — Correcting Insufficient Lump-Sum Payments

During the course of a standard termination, a plan has discovered that a number of lump sum distributions made in past years were underpaid because incorrect actuarial assumptions were used. How should the plan correct these prior underpayments?

RESPONSE:

In general, an underpayment of this kind may be corrected by distributing a make-up payment equal to the amount of the underpayment plus interest from the original payment date to the final distribution date at a reasonable rate.

QUESTION 12

Standard Terminations — Selection of Plans to Audit

How does the PBGC select plan terminations to audit?

RESPONSE:

Under ERISA section 4003(a), the PBGC must audit a statistically significant number of plans terminating in standard terminations, with each audit including a statistically significant number of participants and beneficiaries.

To meet this requirement, the PBGC divides terminated plans into different strata according to plan size and selects plans from each stratum. In previous years, the PBGC divided plans into five strata. Currently, the PBGC divides plans into two strata, using a 500-participant threshold, and selects all plans with a participant count of 500 or more for audit. For plans with a participant count of less than 500, the PBGC randomly selects plans to audit. The PBGC's procedures for selecting terminated plans to audit, including the number of strata and the thresholds between strata, may change from time to time. In addition to this selection process, the PBGC may decide to audit a plan when it has reason to believe there may be a problem, for example, when it receives a complaint by a plan participant or practitioner.

The fact that, upon audit, no violations are found with respect to a plan termination handled by a particular practitioner does not mean that other plan terminations handled by that same practitioner will not be selected for audit.

QUESTION 13

Standard Terminations — Timing of Audit

How can I avoid my plan's being audited long after the termination is completed?

RESPONSE:

In the past, practitioners have expressed concern to the PBGC that standard termination audits often took place long after terminations were completed, when plans records often were not easily available and recollections had faded. In response to these concerns, the PBGC, starting with plan terminations for which the PBGC closed its cases in 1996, began selecting plans to audit on a semi-annual basis. To make audits even more timely, the PBGC since mid-2000 has selected plans to audit on a quarterly basis — in April, July, October, and January of each year — from among those plan terminations for which the PBGC closed its cases in the preceding calendar quarter. The PBGC generally closes its case on a plan termination within a few days after it receives the post-distribution certification (PDC). Therefore, if you want your plan to be included in an audit pool as soon as possible, you should file the PDC as soon as possible. (However, you can file your PDC up to 90 days after the distribution deadline without being subject to a late filing penalty.)

QUESTION 14

Standard Terminations — Effect of Favorable Determination Letter

If the IRS issued a favorable determination letter on a plan's standard termination, why might the PBGC determine that lump sums paid pursuant to the termination violated ERISA and the Internal Revenue Code and that additional benefits would have to be paid?

RESPONSE:

Title IV of ERISA requires the PBGC to audit plans to determine whether participants and beneficiaries have received their benefits. To meet this requirement, the PBGC must determine compliance with Title I. A favorable determination letter issued by the IRS on plan termination is determinative of the issue of tax-qualification but is only prima facie evidence, in accordance with ERISA section 3001(d), of initial compliance with Title I. Accordingly, notwithstanding a favorable IRS determination letter, the PBGC may take enforcement action if it determines that participants and beneficiaries have not received their benefits, whether because the plan administrator did not follow plan provisions or because plan provisions did not comply with the law.

The court in Flo-Con Systems, Inc. v. Pension Benefit Guaranty Corporation upheld the PBGC's claim that a plan was not terminated in accordance with the requirements of ERISA and the Code despite the fact that the IRS had issued a favorable determination letter:

> Flo-Con's argument that the IRS approved of the termination of the Plan is also without merit. The IRS letter merely said the Plan continued to comply with Code requirements for tax qualification. The IRS letter warned Flo-Con that it also had to comply with other federal law. Moreover, a letter of tax qualification is not determinative of the validity of a termination.

39 F. Supp.2d 995, 1001 (C.D. Illinois, 1998) (citation omitted).

QUESTION 15

Reportable Events — *De Minimis* Rules; Multiple-Employer Plans

How do the *de minimis* waiver rules for reportable events apply to multiple-employer plans?

RESPONSE:

There is no restriction on the use of the *de minimis* waiver simply because the plan involved is a multiple-employer plan. As a practical matter, however, there may be cases involving multiple-employer plans where it is impossible to take advantage of the *de minimis* waiver even though the waiver might apply, because information needed to demonstrate that the waiver applies is unavailable. On the other hand (as discussed below), it may sometimes be possible to work around the absence of information and demonstrate that the waiver applies.

To understand the issues, it is necessary to understand the concept of a "plan's controlled group," which is not necessarily the same as a contributing sponsor's controlled group. Under 29 CFR § 4001, "a plan's controlled group means all contributing sponsors of the plan and all members of each contributing sponsor's controlled group." In the case of a multiple-employer plan, this includes members of more than one contributing sponsor's controlled group.

The concept of a "plan's controlled group" pervades the requirements for the *de minimis* waiver. Briefly, a *de minimis* waiver applies if the relevant segment of a plan's controlled group has —

(1) Revenue not over 5 or 10 percent of the revenue of the plan's controlled group;

(2) Operating income not over the greatest of —

(i) 5 or 10 percent of the operating income of the plan's controlled group,

(ii) 5 percent of the first $200 million of the net tangible assets of the plan's controlled group, or

(iii) $5 million; and

(3) Net tangible assets not over —

(i) 5 or 10 percent of the net tangible assets of the plan's controlled group, or

(ii) $5 million.

In order to determine whether a *de minimis* waiver applies, you must generally compare the revenue, operating income, and net tangible assets of the relevant segment of the plan's controlled group with the revenue, operating income, and net tangible assets of the plan's

controlled group as a whole. If the controlled groups of the contributing sponsors of a multiple employer plan are unwilling to share financial data, it is impossible to determine the revenue, operating income, and net tangible assets of the plan's controlled group as a whole. If this unavailable information is needed to demonstrate the applicability of the waiver, the waiver cannot be used.

However, the operating income and net tangible assets tests for a *de minimis* waiver may be met if the relevant segment's operating income and net tangible assets are less than $5 million, regardless of the financial data of the plan's whole controlled group (tests (2)(iii) and (3)(ii) above). Furthermore, it may be possible to demonstrate that the revenue and operating income tests for a *de minimis* waiver are met based on a subset of the plan's whole controlled group (tests (1) and (2)(i) above). (Tests (2)(ii) and (3)(i) above cannot be met without data from the plan's whole controlled group because some group members' net tangible assets figures might be negative.)

For example, suppose Plan X is maintained by contributing sponsors A and K, that A's controlled group consists of A, B, and C, and that K's controlled group consists of K and L. Plan X's controlled group thus consists of A, B, C, K, and L. Suppose the relevant segment of the plan's controlled group is B. In general, to determine whether a *de minimis* waiver applies, B's revenue, operating income, and net tangible assets must be compared to the combined revenue, operating income, and net tangible assets of A, B, C, K, and L. If the K-L and A-B-C controlled groups are unwilling to share financial data, their combined revenue, operating income, and net tangible assets cannot be determined.

However, if B's revenue is less than 5 or 10 percent of the combined revenue of the A-B-C controlled group, then it is clearly less than 5 or 10 percent of the combined revenue of the plan's controlled group as a whole. Similarly, if B's operating income is less than 5 or 10 percent of the combined operating income of the A-B-C controlled group, then it is clearly less than 5 or 10 percent of the combined operating income of the plan's controlled group as a whole. And if B's operating income and net tangible assets are less than $5 million, the operating income and net tangible assets for a waiver may be met.

QUESTION 16

Reportable Events — Retroactively Overdue Contributions

Suppose that a plan sponsor believes that no quarterly installments under Code section 412 for 2001 are required, and none are made; but the plan sponsor later realizes (because of an unanticipated change in facts or assumptions or some other reason) that quarterly installments under Code section 412 should have been made for 2001, and they are then promptly made. What are the consequences?

RESPONSE:

The answer depends on whether or not the missed installments are large enough to trigger the provisions of Code section 412(n).

The conditions for a section 412(n) lien, and thus for filing Form 200, are purely mechanical, and do not involve any element of actual or constructive knowledge or intent. Thus, if the missed quarterly installments or other required payments under Code section 412 are large enough to trigger the provisions of section 412(n), one or more section 412(n) liens arise retroactively and there are one or more retroactive Form 200 filing requirements. The PBGC may therefore assess penalties under ERISA section 4071 against the plan sponsor (and the ultimate parent of the plan sponsor's controlled group, if any) for any failure to file one or more Forms 200 on time. However, based on the facts and circumstances of a particular case, the PBGC might exercise its discretion to assess no section 4071 penalty (or assess a smaller penalty) or to waive any section 4071 penalty in whole or in part. (The PBGC also has discretion not to perfect or enforce section 412(n) liens in such situations.)

If the missed installments do not trigger the provisions of section 412(n), there is no Form 200 filing requirement, but if the installment is not paid within 30 days after its due date, a reportable event notice for a failure to make a required minimum funding payment must be filed. The notice is due within 30 days (subject to extension) after the filer knows or has reason to know that any required installment or other required payment under section 412 has been missed. The notice is timely if it is filed within that time (even if long after the date when the installment should have been paid). If it is not, the PBGC may penalize the plan administrator and contributing sponsor under section 4071 for failure to file on time. Note, however, that the running of the 30-day period within which a filing must be made is triggered when there is reason to know that a contribution was missed, even if the amount is still unknown.

QUESTION 17

Employer Reporting — Determination of Expected Retirement Age (XRA)

When valuing benefit liabilities using PBGC termination assumptions for a filing under ERISA section 4010, how should the actuary determine a participant's "earliest retirement age" ("ERA") and "unreduced retirement age" ("URA") for the XRA table look-up? Specifically, is eligibility service frozen at the valuation date, or should participants be assumed to "grow in" to retirement eligibility based on future service?

RESPONSE:

Eligibility service should be frozen at the valuation date. For example, assume a plan has a normal retirement age of 65 and provides reduced early retirement benefits to participants age 55 with 10 years of vesting service. The plan also provides unreduced early retirement benefits to participants with 30 years of vesting service. For a participant age 30 with ten years of vesting service on the valuation date, the ERA is 55 and the URA is 65. For a participant age 55 with 30 years of vesting service, the ERA and the URA would both be 55.

See also Q&A 25 in the 2000 Bluebook (click “Informal Guidance” under “Business Info” on the PBGC’s web site) regarding selection of the appropriate look-up table (high, medium, or low category).

QUESTION 18

Penalty Policy — Effect of proposed rule

How does the PBGC's recently-published proposed rule on penalty policy relate to the PBGC's current practices?

RESPONSE:

Like any proposed rule, the penalty policy proposal is subject to change and cannot be relied upon. The proposal may generate public comments and may be changed before it is issued in final form. However, the proposed rule is largely reflective of the PBGC's current practices and is consistent with the policy guidance that the PBGC issued in 1995 (60 FR 36837 (July 18, 1995)). Accordingly, it is likely that current case-by-case penalty determinations will be generally consistent with the proposal.

QUESTION 19

Section 4044 — Treatment of Section 401(k) Rollovers

An employer allows participants in a plan that has a Code section 401(k) feature to purchase, on retirement, an annuity from its defined benefit plan. How is this pre-tax money treated under ERISA section 4044 if the defined benefit plan later terminates?

RESPONSE:

This is an issue that the PBGC is looking at closely. The PBGC has not reached any definite conclusion, but the PBGC's preliminary reaction is that the section 401(k) money does not fall under either priority category 1 (PC-1) of section 4044, voluntary employee contributions, or PC-2, mandatory employee contributions. Those classifications appear to be limited to after-tax employee contributions. If the pre-tax contributions do not fall under PC-1 or PC-2, the liabilities due to the pre-tax money would be treated in the same manner as benefits due to employer contributions, *i.e.*, in PC-3 through PC-6.

The PBGC has heard a number of arguments that since the participant elects to make the contribution the money should be treated as elective or mandatory employee contributions under PC-1 or PC-2. On a policy basis, the PBGC has some sympathy for this position because it would encourage annuities and make benefits more portable. However, under the statutory structure the PBGC is having some difficulty reaching that conclusion.

In addition, the PBGC has been made aware that both plans and the PBGC might encounter substantial administrative difficulties if this pre-tax money were treated as employee contributions. Among other things, it seems that few, if any, plans maintain sufficient records to distinguish the portion of an annuity that was purchased with pre-tax employee money from the amount funded by employer contributions. These complexities become even greater in the event of a later plan merger or acquisition by a new plan sponsor.

QUESTION 20

412(n) Liens — Amount of Lien

Can a lien under Code section 412(n) arise where a pension plan's accumulated funding deficiency, as defined in Code section 412(a), is less than one million dollars?

RESPONSE:

Yes. The PBGC recently issued a letter addressing this question. The letter (as redacted) reads as follows:

February 6, 2001

Your letter dated [ ], accompanying the PBGC Form 200 for the [Plan], has been referred to this office for response. In that letter, you question whether a lien under Section 412(n) of the Internal Revenue Code ("Code") and Section 302(f) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA")[1] can arise where a pension plan's accumulated funding deficiency, as defined in Code §412(a), is less than one million dollars. Specifically, you dispute that a lien under Code §412(n) arose in favor of the Plan after the sum of missed contributions exceeded $1 million, because the accumulated funding deficiency of the Plan at the end of the prior plan year was approximately [$630,000].

As more fully explained below, the Pension Benefit Guaranty Corporation ("PBGC") has historically followed the plain meaning of the statutory language under the Code and ERISA, determining (a) whether a lien has arisen and (b) the amount of the lien on the basis of the sum of missed contributions, not on the basis of the accumulated funding deficiency of the plan.

Statutory Background

Code §412(n) was enacted as part of the Pension Protection Act of 1987 (Title IX of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, December 22, 1987). The provision was amended by the Retirement Protection Act of 1994 (included in the Uruguay Round Agreements Act, Pub. L. No. 103-465, December 8, 1994) to alter, *inter alia*, the time when the statutory lien would arise and the amount of the statutory lien.

Code §412(n) protects a pension plan whose contributing sponsor fails to make required contributions. A statutory lien is imposed on all property of the contributing sponsor and that of all members of its controlled group to secure the amount of the missed contributions. The lienholder is the pension plan, but the lien can only be perfected and enforced by the PBGC (or,

---

[1] Because the language of the cited statutes is identical, this letter hereinafter will only make reference to Code §412(n) for convenience.

at the PBGC's direction, by the contributing sponsor or a controlled group member). Code §412(n)(1) & (5). Not all missed contributions trigger a statutory lien.

Code §412(n)(1) provides that a lien arises on all property of a plan sponsor (and each member of its controlled group) when the sum of all missed required installments and other payments to a plan (including interest) exceeds one million dollars as of a due date for such an installment or payment. Code §412(n)(1)(A) makes specific reference to a "required installment under subsection (m)" (Code §412(m)). The only other required payment under Code §412 is the payment required as of the end of a plan year to assure that the plan's funding standard account will not end with a deficit (the "catch-up payment"); that payment is "due" as late as 8-1/2 months after the close of a plan year. Code §412(a), (c)(10)(A). Thus, when the sum of missed §412(m) installments and catch-up payments, plus interest, exceeds one million dollars, a lien arises under §412(n). Similarly, Code §412(n)(3) provides that the amount of the lien is equal to the sum of the missed installments and catch-up payments, including interest.

Nothing in Code §412(n) states explicitly or suggests that the determination of the lien threshold amount or the amount of the lien itself should be based on the accumulated funding deficiency of the pension plan.

Factual Background

As we understand the facts, the contributing sponsor of the Plan failed to make all or a part of a required contribution for the third quarterly installment due on October 15, 1998. Thereafter, eight additional quarterly installments were missed, and the catch-up payments for the 1998 and 1999 plan years were also missed. The table below reflects PBGC's understanding of the amounts required as of each due date with interest to September 15, 2000:

Due Date	PY98	PY99	PY2000	Missed Contributions with Interest to 9/15/2000
10/15/98	[$28,176]			[$32,956]
1/15/99	[$62,569]			[$71,692]
4/15/99		[$80,294]		[$90,170]
7/15/99		[$80,294]		[$88,355]
9/15/99	[$76,780]			[$83,325]
10/15/99		[$80,294]		[$86,557]
1/15/2000		[$80,294]		[$84,795]
4/15/2000			[$160,294]	[$165,870]
7/15/2000			[$160,294]	[$162,530]
9/15/2000		[$319,995]		[$319,995]
			Total:	[$1,186,245]

Once the catch-up payment for the 1999 plan year was missed on September 15, 2000, the sum of all missed installments and other required payments, plus interest, exceeded one million dollars.

In your letter, you suggest that because the Plan's accumulated funding deficiency as of the end of the 1999 plan year was slightly less than [$630,000], no lien could arise on September 15, 2000.

Discussion

Your letter includes an attached statement from the Plan's actuaries asserting that the one million dollar lien triggering threshold in Code §412(n) is based on the accumulated funding deficiency of the Plan, not on the sum of missed contributions. Your actuaries point out that because a prior year's funding deficiency is included in the current year's minimum funding requirements, the PBGC should, in essence, ignore the prior year's missed contributions. Under their view, once it is clear that the prior year will end with a funding deficiency (which will

generally not be known until 8-1/2 months after the close of the prior plan year), PBGC should not include any of the prior year's quarterly installments or the catch-up payment in determining whether a statutory lien arose. Such an approach would produce the following result: after the Plan's sponsor had failed to make the 1998 plan year catch-up payment (due by September 15, 1999), the PBGC would ignore the missed quarterlies that were due on October 15, 1998 and January 15, 1999, as well as the catch-up payment, itself, in determining whether a lien had arisen.

As noted above, the language of Code §412(n) requires a summing of the missed contribution amounts, not a calculation of a plan's accumulated funding deficiency at any given point during a plan year. The statutory provision makes specific reference to quarterly installments and other required payments (catch-up payments). There is no specific reference to the plan's accumulated funding deficiency nor a requirement that the sponsor calculate that deficiency as of each contribution due date to determine whether the deficiency exceeds one million dollars. Congress knew how to make an explicit reference to a plan's accumulated funding deficiency as of a specific date, but it did not do it here. See ERISA §4062(c).

As the table above shows, when the Plan did not receive the catch-up payment due by September 15, 2000, the sum of all missed installments and other required payments, plus interest, exceeded one million dollars, and a lien arose under Code §412(n). We also note that when contributions to the Plan were missed on October 15, 2000, an additional lien arose.

Generally, the amount of the lien determined by adding all prior missed contribution amounts, plus interest, may exceed a pension plan's accumulated funding deficiency. Notwithstanding the lien amount determined and included in the filings made to perfect the lien by PBGC, generally the most that the agency will recover for the plan, in the event enforcement of the lien is necessary, is the amount of the accumulated funding deficiency.

Yours very truly,

[signed]

James J. Keightley
General Counsel