TECHNICAL EXPLANATION OF THE TAX AND PENSION PROVISIONS OF H.R. 3108, THE "PENSION STABILITY ACT," AS PASSED BY THE SENATE ON JANUARY 28, 2004

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INTRODUCTION

H.R. 3108, the "Pension Funding Equity Act of 2003," was passed by the House of Representatives on October 8, 2003. On January 28, 2004, the Senate passed an amendment to H.R. 3108, the "Pension Stability Act." This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a technical explanation of the tax and pension provisions of H.R. 3108, the "Pension Stability Act," as passed by the Senate on January 28, 2004.[2]

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[1] This document may be cited as follows: Joint Committee on Taxation, *Technical Explanation of the Tax and Pension Provisions of H.R. 3108, the "Pension Stability Act," as Passed by the Senate on January 28, 2004* (JCX-12-04), February 9, 2004.

[2] In addition to the tax and pension provisions of the bill, section 12 of the bill repeals section 105 of the Miscellaneous Appropriations and Offsets Act, 2004, i.e., Division H of the Consolidated Appropriations Act, 2004 (the "Act"), Pub. L. No. 108-199, relating to the use of funds made available under the Act to implement measures to reduce overfishing and promote rebuilding of certain fish stocks.

EXPLANATION OF TAX AND PENSION PROVISIONS

A. Temporary Replacement of Interest Rate Used for Certain Pension Plan Purposes and Alternative Deficit Reduction Contribution for Certain Plans (secs. 2-3 of the bill, secs. 412 and 415 of the Code, and secs. 302 and 4006 of ERISA)

Present Law

In general

Under present law, the interest rate on 30-year Treasury securities is used for several purposes related to defined benefit plans. Specifically, the interest rate on 30-year Treasury securities is used: (1) in determining current liability for purposes of the funding and deduction rules; (2) in determining unfunded vested benefits for purposes of Pension Benefit Guaranty Corporation ("PBGC") variable rate premiums; and (3) in determining the minimum required value of lump sum distributions from a defined benefit plan and maximum lump sum values for purposes of the limits on benefits payable under a defined benefit plan.

The IRS publishes the interest rate on 30-year Treasury securities on a monthly basis. The Department of the Treasury does not currently issue 30-year Treasury securities. As of March 2002, the IRS publishes the average yield on the 30-year Treasury bond maturing in February 2031 as a substitute.

Funding rules

In general

The Internal Revenue Code (the "Code") and the Employee Retirement Income Security Act of 1974 ("ERISA") impose both minimum and maximum[3] funding requirements with respect to defined benefit plans.[4] Under the minimum funding rules, the amount of contributions required for a plan year is generally the plan's normal cost for the year (i.e., the cost of benefits allocated to the year under the plan's funding method) plus that year's portion of other liabilities that are amortized over a period of years, such as benefits resulting from a grant of past service credit.

Additional contributions for underfunded plans

Under special funding rules (referred to as the "deficit reduction contribution" rules),[5] an additional contribution to a plan is generally required if the plan's funded current liability

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[3] The maximum funding requirement for a defined benefit plan is referred to as the full funding limitation, discussed below.

[4] Code sec. 412; ERISA sec. 302.

[5] The deficit reduction contribution rules apply to single-employer plans, other than single-employer plans with no more than 100 participants on any day in the preceding plan year.

percentage is less than 90 percent.[6] A plan's "funded current liability percentage" is the actuarial value of plan assets (i.e., the average fair market value over a period of years) as a percentage of the plan's current liability. In general, a plan's current liability means all liabilities to employees and their beneficiaries under the plan.

The amount of the additional contribution required under the deficit reduction contribution rules is the sum of two amounts: (1) the excess, if any, of (a) the deficit reduction contribution (as described below), over (b) the contribution required under the normal funding rules; and (2) the amount (if any) required with respect to unpredictable contingent event benefits.[7] The amount of the additional contribution cannot exceed the amount needed to increase the plan's funded current liability percentage to 100 percent.

The deficit reduction contribution is the sum of (1) the "unfunded old liability amount," (2) the "unfunded new liability amount," and (3) the expected increase in current liability due to benefits accruing during the plan year.[8] The "unfunded old liability amount" is the amount needed to amortize certain unfunded liabilities under 1987 and 1994 transition rules. The "unfunded new liability amount" is the applicable percentage of the plan's unfunded new liability. Unfunded new liability generally means the unfunded current liability of the plan (i.e., the amount by which the plan's current liability exceeds the actuarial value of plan assets), but determined without regard to certain liabilities (such as the plan's unfunded old liability and unpredictable contingent event benefits). The applicable percentage is generally 30 percent, but is reduced if the plan's funded current liability percentage is greater than 60 percent.

Required interest rate and mortality table

Specific interest rate and mortality assumptions must be used in determining a plan's current liability for purposes of the special funding rule. The interest rate used to determine a

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Single-employer plans with more than 100 but not more than 150 participants are generally subject to lower contribution requirements under these rules.

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

[7] A plan may provide for unpredictable contingent event benefits, which are benefits that depend on contingencies that are not reliably and reasonably predictable, such as facility shutdowns or reductions in workforce. An additional contribution is generally not required with respect to unpredictable contingent event benefits unless the event giving rise to the benefits has occurred.

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

plan's current liability must be within a permissible range of the weighted average[9] of the interest rates on 30-year Treasury securities for the four-year period ending on the last day before the plan year begins. The permissible range is generally from 90 percent to 105 percent.[10] The interest rate used under the plan must be consistent with the assumptions which reflect the purchase rates which would be used by insurance companies to satisfy the liabilities under the plan.[11]

The Job Creation and Worker Assistance Act of 2002[12] amended the permissible range of the statutory interest rate used in calculating a plan's current liability for purposes of applying the additional contribution requirements. Under this provision, the permissible range is from 90 percent to 120 percent for plan years beginning after December 31, 2001, and before January 1, 2004.

The Secretary of the Treasury is required to prescribe mortality tables and to periodically review (at least every five years) and update such tables to reflect the actuarial experience of pension plans and projected trends in such experience.[13] The Secretary of the Treasury has required the use of the 1983 Group Annuity Mortality Table.[14]

Full funding limitation

No contributions are required under the minimum funding rules in excess of the full funding limitation. In 2004 and thereafter, the full funding limitation is the excess, if any, of (1) the accrued liability under the plan (including normal cost), over (2) the lesser of (a) the market value of plan assets or (b) the actuarial value of plan assets. However, the full funding limitation may not be less than the excess, if any, of 90 percent of the plan's current liability

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

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

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

[12] Pub. L. No. 107-147.

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

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

(including the current liability normal cost) over the actuarial value of plan assets. In general, current liability is all liabilities to plan participants and beneficiaries accrued to date, whereas the accrued liability under the full funding limitation may be based on projected future benefits, including future salary increases. [15]

Timing of plan contributions

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

In the case of a plan with a funded current liability percentage of less than 100 percent for the preceding plan year, estimated contributions for the current plan year must be made in quarterly installments during the current plan year.[16] The amount of each required installment is 25 percent of the lesser of (1) 90 percent of the amount required to be contributed for the current plan year or (2) 100 percent of the amount required to be contributed for the preceding plan year.[17]

Deductions for contributions

Employer contributions to qualified retirement plans are deductible, subject to certain limits. In the case of a defined benefit plan, the employer generally may deduct the greater of: (1) the amount necessary to satisfy the minimum funding requirement of the plan for the year; or (2) the amount of the plan's normal cost for the year plus the amount necessary to amortize

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

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

[17] In connection with the expanded interest rate range available for 2002 and 2003, special rules apply in determining current liability for the preceding plan year for purposes of applying the quarterly contributions requirements to plan years beginning in 2002 (when the expanded range first applies) and 2004 (when the expanded range no longer applies). In each of those years ("present year"), current liability for the preceding year is redetermined, using the permissible range applicable to the present year. This redetermined current liability will be used for purposes of the plan's funded current liability percentage for the preceding year, which may affect the need to make quarterly contributions, and for purposes of determining the amount of any quarterly contributions in the present year, which is based in part on the preceding year.

certain unfunded liabilities over ten years.[18] In addition, the maximum amount of deductible contributions is generally the greater of: (1) the full funding limitation for the year; or (2) the plan's unfunded current liability.[19]

PBGC premiums

Because benefits under a defined benefit plan may be funded over a period of years, plan assets may not be sufficient to provide the benefits owed under the plan to employees and their beneficiaries if the plan terminates before all benefits are paid. The PBGC generally insures the benefits owed under defined benefit plans (up to certain limits) in the event the plan is terminated with insufficient assets. Employers pay premiums to the PBGC for this insurance coverage.

PBGC premiums include a flat-rate premium and, in the case of an underfunded plan, a variable rate premium based on the amount of unfunded vested benefits.[20] In determining the amount of unfunded vested benefits, the interest rate used is 85 percent of the annual yield on 30-year Treasury securities for the month preceding the month in which the plan year begins.

Under the Job Creation and Worker Assistance Act of 2002, for plan years beginning after December 31, 2001, and before January 1, 2004, the interest rate used in determining the amount of unfunded vested benefits for PBGC variable rate premium purposes is increased to 100 percent of the annual yield on 30-year Treasury securities for the month preceding the month in which the plan year begins.

Lump-sum distributions

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

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

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[18] Code sec. 404(a)(1).

[19] In the case of a plan that terminates during the year, the maximum deductible amount is generally not less than the amount needed to make the plan assets sufficient to fund benefit liabilities as defined for purposes of the PBGC termination insurance program.

[20] ERISA sec. 4006.

Statutory assumptions must be used in determining the minimum value of certain optional forms of benefit, such as a lump sum.[21] That is, the lump sum payable under the plan may not be less than the amount of the lump sum that is actuarially equivalent to the life annuity payable to the participant, determined using the statutory assumptions. The statutory assumptions consist of an applicable mortality table (as published by the IRS) and an applicable interest rate.

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

Limits on benefits

Annual benefits payable under a defined benefit plan generally may not exceed the lesser of (1) 100 percent of average compensation, or (2) $165,000 (for 2004).[22] The dollar limit generally applies to a benefit payable in the form of a straight life annuity beginning no earlier than age 62. The limit is reduced if benefits are paid before age 62. In addition, if the benefit is not in the form of a straight life annuity, the benefit generally is adjusted to an equivalent straight life annuity. In making these reductions and adjustments, the interest rate used generally must be not less than the greater of: (1) five percent; or (2) the interest rate specified in the plan. However, for purposes of adjusting a benefit in a form that is subject to the minimum value rules (including the use of the interest rate on 30-year Treasury securities), such as a lump-sum benefit, the interest rate used must be not less than the greater of: (1) the interest rate on 30-year Treasury securities; or (2) the interest rate specified in the plan.

Explanation of Provision

Interest rate for determining current liability and PBGC premiums

For plan years beginning in 2004 or 2005, the provision changes the interest rate used in determining current liability for funding purposes and in determining PBGC variable rate premiums.[23] For these purposes, the provision replaces the interest rate on 30-year Treasury securities with a conservative long-term bond rate reflecting the rates of interest on amounts invested conservatively in long-term corporate bonds and based on the use of two or more indices that are in the top two quality levels available reflecting average maturities of 20 years or more. The Secretary of the Treasury is directed to prescribe by regulation a method for periodically determining conservative long-term corporate bond rates.

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

[22] Code sec. 415(b).

[23] The provision also repeals the present-law rule under which, for purposes of applying the quarterly contributions requirements to plan years beginning in 2004, current liability for the preceding year is redetermined.

For purposes of determining a plan's current liability for plan years beginning in 2004 or 2005, the interest rate used must be within a permissible range of the weighted average of the conservative long-term corporate bond rates during the four-year period ending on the last day before the plan year begins. The permissible range applicable under the provision is from 90 percent to 100 percent.

The temporary interest rate change generally applies also in determining current liability for purposes of applying the limits on deductible contributions (regardless of whether the plan is subject to the deficit reduction contribution requirements). However, under the provision, an employer may elect to disregard the temporary interest rate change for purposes of determining the maximum amount of deductible contributions (regardless of whether the plan is subject to the deficit reduction contribution requirements). In such a case, the present-law interest rate rules apply, i.e., the interest rate used in determining current liability for that purpose must be within the permissible range (90 to 105 percent) of the weighted average of the interest rates on 30-year Treasury securities for the preceding four-year period.

In determining the amount of unfunded vested benefits for PBGC variable rate premium purposes for plan years beginning in 2004 or 2005, the interest rate used is 85 percent of the annual yield computed by using the conservative long-term corporate bond rate for the month preceding the month in which the plan year begins.

Interest rate for applying limits on benefits

Under the provision, in the case of plan years beginning in 2004 or 2005, in adjusting a form of benefit that is subject to the minimum value rules, such as a lump-sum benefit, for purposes of applying the limits on benefits payable under a defined benefit plan, the interest rate used must be not less than the greater of: (1) 5.5 percent; or (2) the interest rate specified in the plan.

Alternative deficit reduction contribution for certain plans

In general

The provision allows certain employers ("applicable employers") to elect a reduced amount of additional required contribution under the deficit reduction contribution rules (an "alternative deficit reduction contribution") with respect to certain plans for applicable plan years. An applicable plan year is a plan year beginning after December 27, 2003, and before December 28, 2005, for which the employer elects the application of the provision. If an employer so elects, the amount of the additional deficit reduction contribution for an applicable plan year is the greater of: (1) 20 percent (40 percent in the case of a plan year beginning after December 27, 2004) of the amount of the additional contribution that would be required without regard to the provision; or (2) the additional contribution that would be required if the deficit reduction contribution for the plan year were determined as the expected increase in current liability due to benefits accruing during the plan year.

An election under the provision may be made only with respect to a plan that was not subject to the deficit reduction contribution rules for the plan year beginning in 2000. An election may not be made with respect to more than two plan years. An election under the provision is to be made at such time and in such manner as the Secretary of the Treasury prescribes. An election under the provision does not invalidate any obligation pursuant to a collective bargaining agreement in effect on the date of the election to provide benefits, to change the accrual of benefits, or to change the rate at which benefits vest under the plan.

Under the provision, an applicable employer is an employer that is: (1) a commercial passenger airline; (2) primarily engaged in the production or manufacture of a steel mill product, or in the mining or processing of iron ore or beneficiated iron ore products; or (3) an organization described in section 501(c)(5) that established the plan to which the provision applies on June 30, 1955. In addition, an employer not described in the preceding sentence is treated as an applicable employer if the employer files an application (at such time and in such manner as the Secretary of the Treasury prescribes) to be treated as an applicable employer. However, an employer making such an application is not treated as an applicable employer if, within 90 days of the application, the Secretary determines (taking into account the application of the provision) that there is a reasonable likelihood that the employer will be unable to make required future contributions to the plan in a timely manner.

Restrictions on amendments

Under the provision, certain plan amendments may not be adopted during an applicable plan year (i.e., a plan year for which an alternative deficit reduction contribution is elected). This restriction applies to an amendment that increases the liabilities of the plan by reason of any increase in benefits, any change in the accrual of benefits, or any change in the rate at which benefits vest under the plan. The restriction applies unless: (1) the plan's funded current liability percentage as of the end of the aplicable plan year is projected to be at least 75 percent (taking into account the effect of the amendment); (2) the amendment provides for an increase in benefits under a formula that is not based on a participant's compensation, but only if the rate of the increase does not exceed the contemporaneous rate of increase in average wages of participants covered by the amendment; (3) the amendment is required by a collective bargaining agreement that is in effect on the date of enactment of the provision; (4) the amendment is determined by the Secretary of Labor to be reasonable and provides for only de minimis increases in plan liabilities; or (5) the amendment is required as a condition of qualified retirement plan status.

If a plan is amended during an applicable plan year in violation of the provision, an election of an alternative deficit reduction contribution under the provision does not apply to any applicable plan year ending on after the date on which the amendment is adopted.

Notice requirement

The bill amends ERISA to provide that, if an employer elects an alternative deficit reduction contribution for any applicable plan year, the employer must provide written notice of the election to participants and beneficiaries within 30 days of filing the election (120 days in the case of an employer that files an application to be treated as an applicable employer). The notice to participants must include: (1) the due date of the alternative deficit reduction contribution; (2) the amount by which the required contribution to the plan was reduced as a result of the election; (3) a description of the benefits under the plan that are eligible for guarantee by the PBGC; and (4) an explanation of the limitations on the PBGC guarantee and the circumstances in which the limitations apply, including the maximum guaranteed monthly benefits that the PBGC would pay if the plan terminated while underfunded. An employer that fails to provide the required notice to a participant or beneficiary may (in the discretion of a court) be liable to the participant or beneficiary in the amount of up to $100 a day from the date of the failure, and the court may in its discretion order such other relief as it deems proper.

The bill also amends ERISA to require that an employer electing an alternative deficit reduction contribution for any year must provide written notice of the election to the PBGC within 30 days of the election (120 days in the case of an employer that files an application to be treated as an applicable employer). The notice to the PBGC must include: (1) the due date of the alternative deficit reduction contribution; (2) the amount by which the required contribution to the plan was reduced as a result of the election; (3) the number of years it will take to restore the plan to full funding if the employer makes only the required contributions; and (4) information as to how the amount by which the plan is underfunded compares with the capitalization of the employer.

Effective Date

Interest rate

The provision providing a temporary replacement interest rate is generally effective for plan years beginning after December 31, 2003.

For purposes of applying certain rules ("lookback rules") to plan years beginning after December 31, 2003, the amendments made by the provision may be applied as if they had been in effect for all prior plan years. Under the provision, the lookback rules are: (1) the rule under which a plan is not subject to the deficit reduction contribution requirements for a plan year if the plan's funded current liability percentage was at least 90 percent for each of the two immediately preceding plan years or each of the second and third immediately preceding plan years; and (2) the rule under which quarterly contributions are required for a plan year if the plan's funded current liability percentage was less than 100 percent for the preceding plan year.

In the case of a distribution made to a participant or beneficiary after December 31, 2003, and before January 1, 2005, in a form of benefit that is subject to the minimum value rules, such as a lump-sum benefit, and that is subject to adjustment in applying the limit on benefits payable under a defined benefit plan, the amount payable may not, solely by reason of the provision, be less than the amount that would have been payable if the amount payable had been determined using the applicable interest rate in effect as of the last day of the last plan year beginning before January 31, 2004.

Alternative deficit reduction requirement for certain plans

The provision relating to the election of an alternative deficit reduction contribution for certain plans is effective on the date of enactment.

B. Multiemployer Plan Funding Notices (sec. 4 of the bill and sec. 104 of ERISA)

Present Law

Under present law, defined benefit plans are generally required to meet certain minimum funding rules. These rules are designed to help ensure that such plans are adequately funded. Both single-employer plans and multiemployer plans are subject to minimum funding requirements; however, the requirements are different for each type of plan.

Similarly, the Pension Benefit Guaranty Corporation ("PBGC") insures certain benefits under both single-employer and multiemployer defined benefit plans, but the rules relating to the guarantee vary for each type of plan. In the case of multiemployer plans, the PBGC guarantees against plan insolvency. Under its multiemployer program, PBGC provides financial assistance through loans to plans that are insolvent (that is, plans that are unable to pay basic PBGC-guaranteed benefits when due).

Employers maintaining single-employer defined benefit plans are required to provide certain notices to plan participants relating to the funding status of the plan. For example, ERISA requires an employer of a single-employer defined benefit plan to notify plan participants if the employer fails to make required contributions (unless a request for a funding waiver is pending).[24] In addition, in the case of an underfunded plan for which variable rate PBGC premiums are required, the plan administrator generally must notify plan participants of the plan's funding status and the limits on the PBGC benefit guarantee if the plan terminates while underfunded.[25]

Explanation of Provision

In general

The provision amends ERISA to provide that the administrator of a defined benefit plan which is a multiemployer plan is required to provide an annual funding notice to: (1) each participant and beneficiary; (2) each labor organization representing such participants or beneficiaries; and (3) each employer that has an obligation to contribute under the plan.

Such a notice must include: (1) identifying information, including the name of the plan, the address and phone number of the plan administrator and the plan's principal administrative officer, each plan sponsor's employer identification number, and the plan identification number; (2) a statement as to whether the plan's funded current liability percentage for the plan year to which the notice relates is at least 100 percent (and if not, a statement of the percentage); (3) a statement of the value of the plan's assets, the amount of benefit payments, and the ratio of the assets to the payments for the plan year to which the report relates; (4) a summary of the rules

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[24] ERISA sec. 101(d).

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

governing insolvent multiemployer plans, including the limitations on benefit payments and any potential benefit reductions and suspensions (and the potential effects of such limitations, reductions, and suspensions on the plan); (5) a general description of the benefits under the plan which are eligible to be guaranteed by the PBGC and the limitations of the guarantee and circumstances in which such limitations apply; and (6) any additional information which the plan administrator elects to include to the extent it is not inconsistent with regulations prescribed by the Secretary of Labor.

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

The Secretary of Labor is directed to issue regulations (including a model notice) necessary to implement the provision no later than one year after the date of enactment.

Sanction for failure to provide notice

In the case of a failure to provide the annual multiemployer plan funding notice, the Secretary of Labor may assess a civil penalty against a plan administrator of up to $100 per day for each failure to provide a notice. For this purpose, each violation with respect to a single participant or beneficiary is treated as a separate violation.

Effective Date

The provision applies to plan years beginning after December 31, 2004.

C. Amortization Hiatus for Net Experience Losses in Multiemployer Plans (sec. 5 of the bill, sec. 412 of the Code, and sec. 302 of ERISA)

Present Law

General funding requirements

The Code and ERISA impose both minimum and maximum[26] funding requirements with respect to defined benefit plans. Under the minimum funding rules, the amount of contributions required for a plan year is generally the plan's normal cost for the year (i.e., the cost of benefits allocated to the year under the plan's funding method) plus that year's portion of other liabilities that are amortized over a period of years, such as benefits resulting from a grant of past service credit.[27] A plan's normal cost and other liabilities must be determined under an actuarial cost method permissible under the Code and ERISA.

Funding standard account

As an administrative aid in the application of the funding requirements, a defined benefit plan is required to maintain a special account called a "funding standard account" to which specified charges and credits (including credits for contributions to the plan), plus interest, are made for each plan year. If, as of the close of a plan year, the account reflects credits equal to or in excess of charges, the plan is generally treated as meeting the minimum funding standard for the year. Thus, as a general rule, the minimum contribution for a plan year is determined as the amount by which the charges to the account would exceed credits to the account if no contribution were made to the plan. If, as of the close of the plan year, charges to the funding standard account exceed credits to the account, then the excess is referred to as an "accumulated funding deficiency."[28]

Experience gains and losses

In determining plan funding under an actuarial cost method, a plan's actuary generally makes certain assumptions regarding the future experience of a plan. These assumptions typically involve rates of interest, mortality, disability, salary increases, and other factors affecting the value of assets and liabilities, such as increases or decreases in asset values. The actuarial assumptions are required to be reasonable and may be subject to other restrictions. If,

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[26] The maximum funding requirement for a defined benefit plan is referred to as the full funding limitation.

[27] Under special funding rules (referred to as the "deficit reduction contribution" rules), an additional contribution may be required to a single-employer plan if the plan's funded current liability percentage is less than 90 percent. The deficit reduction contribution rules do not apply to multiemployer plans.

[28] In addition to the funding standard account, a reconciliation account is sometimes used to balance certain items for purposes of reporting actuarial information about the plan on the plan's annual report (Schedule B of Form 5500).

on the basis of these assumptions, the contributions made to the plan result in actual unfunded liabilities that are less than those anticipated by the actuary, then the excess is an experience gain. If the actual unfunded liabilities are greater than those anticipated, then the difference is an experience loss.

If a plan has a net experience gain, the funding standard account is credited with the amount needed to amortize the net experience gain over a certain period. If a plan has a net experience loss, the funding standard account is charged with the amount needed to amortize the net experience loss over a certain period. In the case of a multiemployer plan, the amortization period for net experience gains and losses is 15 years.

Excise tax

An employer is generally subject to an excise tax if it fails to make minimum required contributions and fails to obtain a waiver from the IRS.[29] The excise tax is 10 percent of the amount of the funding deficiency (five percent in the case of a multiemployer plan). In addition, a tax of 100 percent may be imposed if the funding deficiency is not corrected within a certain period.

Explanation of Provision

The provision allows certain multiemployer plans to elect to defer the beginning of the amortization of certain net experience losses for up to three plan years. The period during which the amortization of a net experience loss is deferred by reason of such an election is referred to as a "hiatus period." The provision applies to a multiemployer plan that has a net experience loss for any plan year beginning after June 30, 2002, and before July 1, 2006. Such a plan may elect to begin the 15-year amortization period with respect to such a loss in any of the three immediately succeeding plan years as selected by the plan. A plan may elect to delay the beginning of the amortization of net experience losses with respect to net experience losses occurring for only two plan years beginning after June 30, 2002, and before July 1, 2006 (regardless of the number of plan years in that period for which the plan has net experience losses). An election under the provision is to be made at such time and in such manner as the Secretary of Labor prescribes, after consultation with the Secretary of the Treasury.

If an election under the provision is made, the net experience loss is treated, for purposes of determining any charge to the funding standard account (or interest) with respect to the loss, in the same manner as if the net experience loss occurred in the year selected by the plan for the amortization period to begin (without regard to any net experience loss or gain otherwise determined for such year). Interest accrued on any net experience loss during a hiatus period is charged to a reconciliation account and not to the funding standard account.

Under the provision, certain plan amendments may not take effect for any plan year in the hiatus period. This restriction applies to an amendment that increases the liabilities of the plan by reason of any increase in benefits, any change in the accrual of benefits, or any change in the

[29] Sec. 4971.

rate at which benefits vest under the plan. The restriction applies unless: (1) the plan's funded current liability percentage as of the end of the plan year is projected to be at least 75 percent (taking into account the effect of the amendment); (2) the plan's actuary certifies that, due to an increase in the rates of contributions to the plan, the normal cost attributable to the benefit increase or other change is expected to be fully funded in the year following the year in which the increase or other change takes effect, and any increase in the plan's accrued liabilities attributable to the benefit increase or other change is expected to be fully funded by the end of the third plan year following the end of the plan hiatus period of the plan; (3) the amendment is determined by the Secretary of Labor to be reasonable and provides for only de minimis increases in plan liabilities; or (4) the amendment is required as a condition of qualified retirement plan status. The restriction on amendments does not apply to an increase in benefits for a group of participants resulting solely from a collectively bargained increase in the contributions on their behalf. Under the provision, failure to comply with this restriction is a violation of ERISA and of the qualification requirements of the Code.

If a plan elects to defer the beginning of an amortization period under the provision, the plan administrator must provide written notice of the election within 30 days to participants and beneficiaries, to each labor organization representing participants and beneficiaries, and to each employer that has an obligation to contribute under the plan. The notice must include: (1) the amount of the net experience loss to be deferred under the election and the period of the deferral; and (2) the maximum guaranteed monthly benefits that the PBGC would pay if the plan terminated while underfunded. If a plan administrator fails to comply with the notice requirement under the provision, the Secretary of Labor may assess a civil penalty of not more than $1,000 a day for each violation.

Effective Date

The provision is effective on the date of enactment.

D. Two-Year Extension of Transition Rule to Pension Funding Requirements (sec. 6 of the bill and sec. 769(c) of the Retirement Protection Act of 1994)

Present Law

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

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

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

The special rule treats a plan to which it applies as having a funded current liability percentage of at least 90 percent for plan years beginning after 1996 and before 2005 if for such plan year the funded current liability percentage is at least 85 percent. If the funded current liability of the plan is less than 85 percent for any plan year beginning after 1996 and before 2005, the relief from the minimum funding requirements applies only if certain specified contributions are made.

For plan years beginning after 2004 and before 2010, the funded current liability percentage will be deemed to be at least 90 percent if the actual funded current liability percentage is at least at certain specified levels. The relief from the minimum funding requirements applies for a plan year beginning in 2005, 2006, 2007, or 2008 only if contributions to the plan for the plan year equal at least the expected increase in current liability due to benefits accruing during the plan year.

Explanation of Provision

The provision modifies the special funding rules for plans sponsored by a company engaged primarily in interurban or interstate passenger bus service by providing that, for plan years beginning in 2004 and 2005, the funded current liability percentage of the plan will be treated as at least 90 percent for purposes of determining the amount of required contributions (100 percent for purposes of determining whether quarterly contributions are required). As a result, for these years, additional contributions and quarterly contributions are not required with respect to the plan. In addition, for these years, the mortality table used under the plan is used in determining the amount of unfunded vested benefits under the plan for purposes of calculating PBGC variable rate premiums.

Effective Date

The provision is effective with respect to plan years beginning after December 31, 2003.

E. Procedures Applicable to Disputes Involving Pension Plan Withdrawal Liability (sec. 7 of the bill and sec. 4221 of ERISA)

Present Law

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

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

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

Explanation of Provision

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

Effective Date

The provision applies to an employer that receives a notification of withdrawal liability and demand for payment under ERISA section 4219(b)(1) after October 31, 2003.

F. Sense of the Senate on the Status of Private Pension Plans (sec. 8 of the bill)

Present Law

No provision.

Explanation of Provision

The bill makes various findings of the Congress relating to the private pension system and the Pension Benefit Guaranty Corporation ("PBGC") and expresses the sense of the Senate with respect to future legislative action.

Specifically, the bill provides that the Congress makes the following findings:

- The private pension system is integral to the retirement security of Americans, along with individual savings and Social Security.
- The PBGC is responsible for insuring the nation's private pension system, and currently insures the pensions of 34,500,000 participants in 29,500 single-employer plans, and 9,700,000 participants in more than 1,600 multiemployer plans;
- The PBGC announced on January 15, 2004, that it suffered a net loss in fiscal year 2003 of $7,600,000,000 for single-employer pension plans, bringing the PBGC's deficit to $11,200,000,000. This deficit is the PBGC's worst on record, three times larger than the $3,600,000,000 deficit experienced in fiscal year 2002.
- The PBGC also announced that the separate insurance program for multiemployer pension plans sustained a net loss of $419,000,000 in fiscal year 2003, resulting in a fiscal year-end deficit of $261,000,000. The 2003 multiemployer plan deficit is the first deficit in more than 20 years and is the largest deficit on record.
- The PBGC estimates that the total underfunding in multiemployer pension plans is roughly $100,000,000,000 and in single-employer plans is approximately $400,000,000,000. This underfunding is due in part to the recent decline in the stock market and low interest rates, but is also due to demographic changes. For example, in 1980, there were four active workers for every one retiree in a multiemployer plan, but in 2002, there was only one active worker for every one retiree.
- This pension plan underfunding is concentrated in mature and often-declining industries, where plan liabilities will come due sooner.
- Neither the Senate Committee on Finance nor the Senate Committee on Health, Education, Labor and Pensions ("HELP"), the committees of jurisdiction over pension matters, has held hearings this Congress nor reported legislation addressing the funding of multiemployer pension plans.
- The Senate is concerned about the current funding status of the private pension system, both single and multiemployer plans.
- The Senate is concerned about the potential liabilities facing the PBGC and, as a result, the potential burdens facing healthy pension plans and taxpayers.

In addition, the bill provides that it is the sense of the Senate that the Committee on Finance and the Committee on Health, Education, Labor and Pensions should conduct hearings on the status of multiemployer pension plans and should work in consultation with the Departments of Labor and Treasury on permanent measures to strengthen the integrity of the private pension system in order to protect the benefits of current and future pension plan beneficiaries.

Effective Date

The provision is effective on the date of enactment.

G. Extension of Provision Permitting Qualified Transfers of Excess Pension Assets to Retiree Health Accounts (sec. 9 of the bill, sec. 420 of the Code, and secs. 101, 403, and 408 of ERISA)

Present Law

Defined benefit plan assets generally may not revert to an employer prior to termination of the plan and satisfaction of all plan liabilities. In addition, a reversion may occur only if the plan so provides. A reversion prior to plan termination may constitute a prohibited transaction and may result in plan disqualification. Any assets that revert to the employer upon plan termination are includible in the gross income of the employer and subject to an excise tax. The excise tax rate is 20 percent if the employer maintains a replacement plan or makes certain benefit increases in connection with the termination; if not, the excise tax rate is 50 percent. Upon plan termination, the accrued benefits of all plan participants are required to be 100-percent vested.

A pension plan may provide medical benefits to retired employees through a separate account that is part of such plan. A qualified transfer of excess assets of a defined benefit plan to such a separate account within the plan may be made in order to fund retiree health benefits.[30] A qualified transfer does not result in plan disqualification, is not a prohibited transaction, and is not treated as a reversion. Thus, transferred assets are not includible in the gross income of the employer and are not subject to the excise tax on reversions. No more than one qualified transfer may be made in any taxable year. A qualified transfer can be made only from a single-employer plan.

Excess assets generally means the excess, if any, of the value of the plan's assets[31] over the greater of (1) the accrued liability under the plan (including normal cost) or (2) 125 percent of the plan's current liability.[32] In addition, excess assets transferred in a qualified transfer may not exceed the amount reasonably estimated to be the amount that the employer will pay out of such account during the taxable year of the transfer for qualified current retiree health liabilities. No deduction is allowed to the employer for (1) a qualified transfer or (2) the payment of qualified current retiree health liabilities out of transferred funds (and any income thereon).

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[30] Sec. 420.

[31] The value of plan assets for this purpose is the lesser of fair market value or actuarial value.

[32] In the case of plan years beginning before January 1, 2004, excess assets generally means the excess, if any, of the value of the plan's assets over the greater of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) 170 percent of the plan's current liability (for 2003), or (2) 125 percent of the plan's current liability. The current liability full funding limit was repealed for years beginning after 2003. Under the general sunset provision of EGTRRA, the limit is reinstated for years after 2010.

Transferred assets (and any income thereon) must be used to pay qualified current retiree health liabilities for the taxable year of the transfer. Transferred amounts generally must benefit pension plan participants, other than key employees, who are entitled upon retirement to receive retiree medical benefits through the separate account. Retiree health benefits of key employees may not be paid out of transferred assets.

Amounts not used to pay qualified current retiree health liabilities for the taxable year of the transfer are to be returned to the general assets of the plan. These amounts are not includible in the gross income of the employer, but are treated as an employer reversion and are subject to a 20-percent excise tax.

In order for the transfer to be qualified, accrued retirement benefits under the pension plan generally must be 100-percent vested as if the plan terminated immediately before the transfer (or in the case of a participant who separated in the one-year period ending on the date of the transfer, immediately before the separation).

In order for a transfer to be qualified, the employer generally must maintain retiree health benefits at the same level for the taxable year of the transfer and the following four years.

In addition, the ERISA provides that, at least 60 days before the date of a qualified transfer, the employer must notify the Secretary of Labor, the Secretary of the Treasury, employee representatives, and the plan administrator of the transfer, and the plan administrator must notify each plan participant and beneficiary of the transfer.[33]

No qualified transfer may be made after December 31, 2005.

Explanation of Provision

The provision allows qualified transfers of excess defined benefit plan assets through December 31, 2013.

Effective Date

The provision is effective on the date of enactment.

[33] ERISA sec. 101(e). ERISA also provides that a qualified transfer is not a prohibited transaction under ERISA or a prohibited reversion.

H. Modify Qualification Rules for Tax-Exempt Property and Casualty Insurance Companies (sec. 10 of the bill and secs. 501 and 831 of the Code)

Present Law

A property and casualty insurance company generally is subject to tax on its taxable income (sec. 831(a)). The taxable income of a property and casualty insurance company is determined as the sum of its underwriting income and investment income (as well as gains and other income items), reduced by allowable deductions (sec. 832).

A property and casualty insurance company is eligible to be exempt from Federal income tax if its net written premiums or direct written premiums (whichever is greater) for the taxable year do not exceed $350,000 (sec. 501(c)(15)).

A property and casualty insurance company may elect to be taxed only on taxable investment income if its net written premiums or direct written premiums (whichever is greater) for the taxable year exceed $350,000, but do not exceed $1.2 million (sec. 831(b)).

For purposes of determining the amount of a company's net written premiums or direct written premiums under these rules, premiums received by all members of a controlled group of corporations of which the company is a part are taken into account. For this purpose, a more-than-50-percent threshhold applies under the vote and value requirements with respect to stock ownership for determining a controlled group, and rules treating a life insurance company as part of a separate controlled group or as an excluded member of a group do not apply (secs. 501(c)(15), 831(b)(2)(B) and 1563).

Explanation of Provision

The provision modifies the requirements for a property and casualty insurance company to be eligible for tax-exempt status, and to elect to be taxed only on taxable investment income.

Under the provision, a property and casualty insurance company is eligible to be exempt from Federal income tax if (a) its gross receipts for the taxable year do not exceed $600,000, and (b) the premiums received for the taxable year are greater than 50 percent of its gross receipts. For purposes of determining gross receipts, the gross receipts of all members of a controlled group of corporations of which the company is a part are taken into account. The provision expands the present-law controlled group rule so that it also takes into account gross receipts of foreign and tax-exempt corporations.

A company that does not meet the definition of an insurance company is not eligible to be exempt from Federal income tax under the provision. For this purpose, the term "insurance company" means any company, more than half of the business of which during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies (sec. 816(a) and new sec. 831(c)). A company whose investment activities outweigh its insurance activities is not considered to be an insurance company for this purpose.[34] It is intended that IRS enforcement activities address the misuse of present-law section 501(c)(15).

The provision also provides that a property and casualty insurance company may elect to be taxed only on taxable investment income if its net written premiums or direct written premiums (whichever is greater) do not exceed $1.2 million (without regard to whether such premiums exceed $350,000) (sec. 831(b)). As under present law, for purposes of determining the amount of a company's net written premiums or direct written premiums under this rule, premiums received by all members of a controlled group of corporations (as defined in section 831(b)) of which the company is a part are taken into account.

It is intended that regulations or other Treasury guidance provide for anti-abuse rules so as to prevent improper use of the provision, including, for example, by attempts to characterize as premiums any income that is other than premium income.

Effective Date

The provisions are effective for taxable years beginning after December 31, 2003.

[34] *See, e.g., Inter-American Life Insurance Co. v. Comm'r*, 56 T.C. 497, aff'd per curiam, 469 F.2d 697 (9th Cir. 1972).

I. Definition of Insurance Company for Property and Casualty Insurance Company Tax Rules (sec. 11 of the bill and sec. 831 of the Code)

Present Law

Present law provides specific rules for taxation of the life insurance company taxable income of a life insurance company (sec. 801), and for taxation of the taxable income of an insurance company other than a life insurance company (sec. 831) (generally referred to as a property and casualty insurance company). For Federal income tax purposes, a life insurance company means an insurance company that is engaged in the business of issuing life insurance and annuity contracts, or noncancellable health and accident insurance contracts, and that meets a 50-percent test with respect to its reserves (sec. 816(a)). This statutory provision applicable to life insurance companies explicitly defines the term "insurance company" to mean any company, more than half of the business of which during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies (sec. 816(a)).

The life insurance company statutory definition of an insurance company does not explicitly apply to property and casualty insurance companies, although a long-standing Treasury regulation[35] that is applied to property and casualty companies provides a somewhat similar definition of an "insurance company" based on the company's "primary and predominant business activity."[36]

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35 The Treasury regulation provides that "the term 'insurance company' means a company whose primary and predominant business activity during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies. Thus, though its name, charter powers, and subjection to State insurance laws are significant in determining the business which a company is authorized and intends to carry on, it is the character of the business actually done in the taxable year which determines whether a company is taxable as an insurance company under the Internal Revenue Code." Treas. Reg. sec. 1.801-3(a)(1).

36 Court cases involving a determination of whether a company is an insurance company for Federal tax purposes have examined all of the business and other activities of the company. In considering whether a company is an insurance company for such purposes, courts have considered, among other factors, the amount and source of income received by the company from its different activities. *See Bowers v. Lawyers Mortgage Co.*, 285 U.S. 182 (1932); *United States v. Home Title Insurance Co.*, 285 U.S. 191 (1932). *See also Inter-American Life Insurance Co. v. Comm'r*, 56 T.C. 497, aff'd per curiam, 469 F.2d 697 (9th Cir. 1972), in which the court concluded that the company was not an insurance company: "The . . . financial data clearly indicates that petitioner's primary and predominant source of income was from its investments and not from issuing insurance contracts or reinsuring risks underwritten by insurance companies. During each of the years in issue, petitioner's investment income far exceeded its premiums and the amounts of earned premiums were de minimis during those years. It is equally as clear that petitioner's primary and predominant efforts were not expended in issuing insurance contracts or in reinsurance. Of the relatively few policies directly written by

When enacting the statutory definition of an insurance company in 1984, Congress stated, "[b]y requiring [that] more than half rather than the 'primary and predominant business activity' be insurance activity, the bill adopts a stricter and more precise standard for a company to be taxed as a life insurance company than does the general regulatory definition of an insurance company applicable for both life and nonlife insurance companies . . . Whether more than half of the business activity is related to the issuing of insurance or annuity contracts will depend on the facts and circumstances and factors to be considered will include the relative distribution of the number of employees assigned to, the amount of space allocated to, and the net income derived from, the various business activities."[37]

Explanation of Provision

The provision provides that, for purposes of determining whether a company is a property and casualty insurance company, the term "insurance company" is defined to mean any company, more than half of the business of which during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies. Thus, the provision conforms the definition of an insurance company for purposes of the rules taxing property and casualty insurance companies to the rules taxing life insurance companies, so that the definition is uniform. The provision adopts a stricter and more precise standard than the "primary and predominant business activity" test contained in Treasury Regulations. A company whose investment activities outweigh its insurance activities is not considered to be an insurance company under the provision.[38] It is not intended that a company whose sole activity is the run-off of risks under the company's insurance contracts be treated as a company other than an insurance company, even if the company has little or no premium income.

Effective Date

The provision applies to taxable years beginning after December 31, 2003.

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petitioner, nearly all were issued to [family members]. Also, Investment Life, in which [family members] each owned a substantial stock interest, was the source of nearly all of the policies reinsured by petitioner. These facts, coupled with the fact that petitioner did not maintain an active sales staff soliciting or selling insurance policies . . . , indicate a lack of concentrated effort on petitioner's behalf toward its chartered purpose of engaging in the insurance business. . . . For the above reasons, we hold that during the years in issue, petitioner was not 'an insurance company . . . engaged in the business of issuing life insurance' and hence, that petitioner was not a life insurance company within the meaning of section 801." 56 T.C. 497, 507-508.

[37] H.R. Rep. 98-432, part 2, at 1402-1403 (1984); S. Prt. No. 98-169, vol. I, at 525-526 (1984); *see also* H.R. Rep. No. 98-861 at 1043-1044 (1985) (Conference Report).

[38] *See Inter-American Life Insurance Co. v. Comm'r*, *supra.*