

paragraph (c)(6)(i) of this section to interest income with respect to certain intercompany obligations the interest deduction on which is disallowed under section 265(a)(2). \* \* \*

\* \* \* \* \*

(iii) *Effective date.* The third sentence of paragraph (c)(6)(ii)(A) of this section shall apply to taxable years beginning on or after the date these regulations are published as final regulations in the **Federal Register**.

\* \* \* \* \*

(g) \* \* \*

(5) \* \* \*

*Example 1* \* \* \*

\* \* \* \* \*

(d) *Tax-exempt income.* The facts are the same as in paragraph (a) of this *Example 1*, except that B's borrowing from S is allocable under section 265 to B's purchase of state and local bonds to which section 103 applies and §1.265-2(c) does not apply. \* \* \*

\* \* \* \* \*

Mark E. Matthews,  
*Deputy Commissioner for  
Services and Enforcement.*

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## Election of Alternative Deficit Reduction Contribution

### Announcement 2004-43

This announcement provides guidance on the notices that must be given by an employer to plan participants and their beneficiaries and to the Pension Benefit Guaranty Corporation (the "PBGC") if the employer elects the alternative deficit reduction contribution under § 412(l)(12) of the Internal Revenue Code (the "Code") and section 302(d)(12) of the Employee Retirement Income Security Act of 1974 ("ERISA"), as added by section 102 of the Pension Funding Equity Act of 2004, Pub. L. 108-218 ("PFEA'04"). This announcement also sets forth timing requirements for the election.

## I. Background

Section 102 of PFEA'04, which was enacted on April 10, 2004, added § 412(l)(12) to the Code and section 302(d)(12) to ERISA. Section 412(l)(12) of the Code permits certain employers who are required to make additional contributions under § 412(l) to elect a reduced amount of those contributions ("alternative deficit reduction contributions") for certain plan years. An employer is eligible to make such an election if it is (1) a commercial passenger airline, (2) primarily engaged in the production or manufacture of a steel mill product or the processing of iron ore pellets, or (3) an organization described in § 501(c)(5) that established a plan on June 30, 1955, to which § 412 now applies. On April 12, 2004, the Internal Revenue Service (the "Service") issued Announcement 2004-38, 2004-18 I.R.B. 878, which provides guidance for making the election for an alternative deficit reduction contribution.

Section 302 of ERISA contains minimum funding standard requirements that are parallel to those under § 412 of the Code, and section 302(d)(12) of ERISA provides an election that is identical to the election under § 412(l)(12) of the Code. Moreover, section 302(d)(12)(E) of ERISA requires an employer that elects an alternative deficit reduction contribution under section 302(d)(12) of ERISA and § 412(l)(12) of the Code for any year to provide certain notices to the participants and beneficiaries under the plan and to the PBGC. The notices must be provided within 30 days of the filing of the election for such year, and the written notices of the election must specify various information.

Section 302(d)(12)(F) of ERISA as added by section 102(a) of PFEA'04 authorizes the Secretary of the Treasury to prescribe the time and manner of making an alternative deficit reduction contribution election. In addition, under section 101 of Reorganization Plan No. 4 of 1978, 1979-1 C.B. 480, the Secretary of the Treasury has sole interpretive authority (except for certain matters not relevant here) over the subject matter addressed in this announcement.

Section 102(d) of PFEA'04 amended section 502(c)(3) of ERISA to provide that if an employer fails to provide the required notices on a timely basis to a participant or

beneficiary, or to the PBGC, that employer may be liable to such participant or beneficiary or to the PBGC, in the discretion of the court, for a penalty of up to \$100 a day from the date of the failure, or such other relief as the court deems proper.

## II. Required Notice to Participants and Beneficiaries

A. *Explanation of Context*—Pursuant to section 302(d)(12)(E)(i) of ERISA, an employer that elects an alternative deficit reduction contribution must provide written notice of the election to each participant and to each beneficiary under the plan ("the participant notice") and must explain the context in which the information set forth in section II.B. of this announcement is being provided. This requirement to explain the context is satisfied if the notice includes the following information:

"As permitted under a new law called the Pension Funding Equity Act of 2004, Pub. L. 108-218 ("PFEA'04"), [enter name of corporation] has made a special election that reduces the amount of contributions that are required to be made for [enter plan year] to [enter name of pension plan]. The election was made on [enter date of election]. The following information is being provided to you pursuant to the new law."

B. *Information Required in Notice to Participants and Beneficiaries*—Pursuant to section 302(d)(12)(E)(i) of ERISA, the participant notice must also include the information described in this Section II.B.

### 1. *Due Date of the Alternative Deficit Reduction Contribution and Amount by Which Required Contribution is Reduced*

The participant notice must specify the following information with respect to the due date and the reduction in required contributions resulting from the alternative deficit reduction contribution election for the plan year:

a. The amount of the required minimum contribution under § 412 of the Code for the plan year for which the alternative deficit reduction contribution election was made, calculated taking into account that election;

b. The amount of the required minimum contribution under § 412 for the plan

year for which the alternative deficit reduction contribution election was made, calculated without taking into account the election;

c. The due date of the required minimum contribution under § 412 for the plan year for which the alternative deficit reduction contribution election was made; and

d. If the electing employer is required to make quarterly contributions to the plan for the plan year for which the election is made, the aggregate amount of the required minimum contribution under § 412 for the plan year that is required to be paid in quarterly installments (calculated taking into account the election).

The employer may provide reasonable estimates of the amounts described above, and the participant notice may also specify the amount and date of any contributions that were made for the plan year prior to the date of the participant notice.

## 2. *Benefits Eligible for Guarantee and Limitations on Guarantee*

The participant notice must include a description of the benefits under the plan that are eligible for guarantee by the PBGC, an explanation of the limitations on the PBGC's 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. This requirement will be satisfied if an employer includes in the participant notice the text from the portion of the model notice in Appendix A to 29 CFR Part 4011 that is found under the heading "PBGC Guarantees."

### C. *Method of Delivery*

The delivery requirement for the participant notice is treated as satisfied if the participant notice is mailed to the last known address of each participant or beneficiary.

## III. **Required Notice to PBGC**

Pursuant to section 302(d)(12)(E)(iii) of ERISA an employer electing an alternative deficit reduction contribution must provide the information described in this section.

### A. *Due Date of the Alternative Deficit Reduction Contribution and Amount by Which Required Contribution Was Reduced*

This PBGC notice must include the information regarding the contribution amounts and due dates set forth in the description of the participant notice in section II.B.1. of this announcement.

### B. *Time to Restore Plan to Full Funding*

The PBGC notice must include the number of years it will take to restore the plan to full funding if the employer only makes the required minimum contributions. For this purpose, a plan will be considered to be in full funding for a plan year if, for the plan year, the plan is subject to the full-funding limitation of § 412(c)(7), taking into account the 90% override of § 412(c)(7)(E).

The projection of when the plan will be in full funding must be based on reasonable actuarial assumptions and, for plan years beginning in 2006 and later years, must reflect the interest rate rules (§§ 412(b)(5)(ii)(III) and 412(l)(7)(C)(i)(II)) that are applicable for plan years beginning after 2005. In addition, the PBGC notice must also include the required minimum contributions that form the basis of the projections for the plan year of the election and each of the 4 subsequent plan years.

### C. *Comparison of Underfunded Amount with Capitalization*

The PBGC notice must include (1) the amount by which the plan is underfunded and (2) the capitalization of the employer making the election.

For purposes of providing the amount by which the plan is underfunded, the PBGC notice must include the plan's termination liability as of a date within the most recently ended plan year and the market value of plan assets as of that date.

In the case of an employer whose stock is publicly traded, the capitalization of the employer is the product of the number of outstanding shares of stock and the market price per share. In the case of any other employer, the capitalization information required to be shown is the following: (1) the fair market value of total as-

sets, (2) total liabilities, (3) stockholder equity (deficit), (4) paid-in capital, and (5) retained earnings (accumulated loss).

The capitalization information should be shown as of the same date for which the underfunded amount in the paragraph above is specified. If, however, the capitalization information is not available as of such date, capitalization information as of the end of the most recently ended fiscal year of the corporation may be substituted.

### *Method of Delivery*

The delivery requirement for the PBGC notice is set forth on the PBGC's website at [www.pbgc.gov](http://www.pbgc.gov).

## IV. **Time For Making Election**

Pursuant to the authority contained in section 302(d)(12)(F) of ERISA, and subject to the transition rule in Section V of this announcement, an election to make the alternative deficit reduction contribution for any plan year must be made by the end of the first quarter of that plan year.

## V. **Transition**

Notwithstanding the requirement to make an election by the end of the first quarter of the plan year, the following transitional rules are applicable. If an employer makes an alternative deficit reduction contribution election on or before June 30, 2004, that election will be deemed timely for the plan year that begins during calendar 2004. In addition, if an employer issues a PBGC notice for a plan on or before June 5, 2004, the PBGC will treat the PBGC notice as timely issued.

## VI. **Paperwork Reduction Act**

The collection of information contained in this announcement has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1884.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collection of information in this announcement is in sections II and III. This information is required to meet the

requirements of section 102 of the Pension Funding Equity Act of 2004 to monitor and make valid determinations with respect to employers that elect an alternative deficit reduction contribution for certain plans. As a result of such elections, an employer's deficit reduction contribution for certain plans will be based on amounts specified under § 412(l)(12) of the Code. If an employer does not give timely notice of an election to make a deficit reduction contribution (including all of the requirements described above), a court may in its discretion impose a penalty. The likely respondents are businesses or other for-profit institutions, and nonprofit institutions.

The estimated total annual reporting and/or recordkeeping burden is 12,000 hours.

The estimated annual burden per respondent/recordkeeper varies from 20 to 100 hours, depending on individual circumstances, with an estimated average of 60 hours. The estimated number of respondents and/or recordkeepers is 200.

The estimated frequency of responses is occasional.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. § 6103.

## VII. Effect on Other Documents

Announcement 2004-38, 2004-18 I.R.B. 878, is modified.

## Drafting Information

The principal authors of this announcement are James E. Holland and Michael Rubin of the Employee Plans, Tax Exempt and Government Entities Division. Mr. Holland may be reached at 1-202-283-9699 and Mr. Rubin may be reached at 1-202-283-9888 (not toll-free numbers).

## Application of Sections 265(a)(2) and 246A in Multi-Party Financing Arrangements; Request for Comments

### Announcement 2004-44

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: The IRS and Treasury Department are soliciting comments and suggestions regarding the scope and details of regulations (REG-128572-03) that may be proposed under section 7701(f) of the Internal Revenue Code to address the application of sections 265(a)(2) and 246A in transactions involving related parties, pass-through entities, or other intermediaries.

DATES: Written or electronic comments must be submitted by August 5, 2004.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG-128572-03), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-128572-03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC or sent electronically, via the IRS Internet site at [www.irs.gov/regs](http://www.irs.gov/regs) or via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS and REG-128572-03).

#### FOR FURTHER INFORMATION CONTACT:

Concerning submissions, LaNita Van Dyke, (202) 622-7180; concerning the notice, Avital Grunhaus, (202) 622-3930 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background

Section 163(a) generally allows a deduction for all interest paid or accrued within the taxable year on indebtedness. Section 265(a)(2), however, provides that

no deduction shall be allowed for interest on indebtedness incurred or continued to purchase or carry obligations the interest on which is wholly exempt from Federal income taxes.

Generally, section 246A reduces the dividends received deduction under section 243, 244, or 245(a) to the extent that the portfolio stock, with respect to which the dividends are received, is debt-financed. Stock is treated as debt-financed if there is indebtedness directly attributable to the stock investment.

Section 7701(f) provides that the Secretary shall prescribe such regulations as may be necessary or appropriate to prevent the avoidance of the provisions of the Internal Revenue Code that deal with (1) the linking of borrowing to investment, or (2) diminishing risk, through the use of related persons, pass-thru entities, or other intermediaries.

Concurrent with the publication of this advance notice of proposed rulemaking in the **Federal Register**, the IRS and Treasury are issuing Rev. Rul. 2004-47, 2004-21 I.R.B. 941, which provides guidance on the application of section 265(a)(2) to disallow a portion of interest incurred by one member of an affiliated group when it transfers borrowed funds to another member of the group that is a dealer in tax-exempt bonds. In the circumstances described in *Situations 1* and *2* of that ruling, the funds borrowed by one member are directly traceable to the funds the borrowing member transfers to the dealer member. Under Rev. Proc. 72-18, 1972-1 C.B. 740, the application of section 265(a)(2) to these facts requires a determination of the borrowing member's purpose for incurring or continuing each item of indebtedness. The revenue ruling holds that the purpose of the borrowing member is determined by reference to the use of the borrowed funds in the business of the dealer member to whom the funds are made available. This conclusion is based on *H Enterprises International v. Commissioner*, 75 T.C.M. 1948 (1998), *aff'd per curiam*, 183 F.3d 907 (8<sup>th</sup> Cir. 1999). The result is a disallowance of the borrowing member's interest expense under section 265(a)(2).

In *H Enterprises*, a parent and a subsidiary were members of the same consolidated group of corporations. The subsidiary declared a dividend and, a few