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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

SEP 16 2004

Uniform Issue List: 404.15-00

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Legend

Company P = * * *
Pension Plan = * * *

Dear * * *:

This letter is in response to your ruling request dated June 30, 2004, supplemented by letter dated August 16, 2004, in which your authorized representative requested a ruling on your behalf concerning the determination of the unfunded current liability deduction limit for a pension plan under section 404(a)(1)(D)(i) of the Internal Revenue Code ("Code").

The following facts and representations have been submitted under penalty of perjury in support of the ruling requested:

Company P owns and operates a chain of retail stores and several related businesses. Company P's taxable year for income tax purposes is the 52-53 week fiscal year that ends on the last Saturday of each January. The most recently ended fiscal year (hereinafter "Fiscal "), which contained 53 weeks, ended January 31, .

Company P sponsors the Pension Plan. A favorable determination letter was issued on qualifying the Pension Plan under section 401(a) of the Code with a trust exempt from tax under section 501(a) of the Code. The Pension Plan operates on a calendar year plan year. Thus, Company P's taxable year does not coincide with the Pension Plan's plan year. The limit on the Pension Plan's deductions is determined with reference to the plan year beginning within Company P's tax year. Company P proposes to make a contribution to the Pension Plan of up to * * * (the "Contribution") prior to the time prescribed by law for filing the return for such taxable year (including extensions) and in compliance with section 404(a)(6) of the Code. Company P proposes to take a corresponding deduction for the Contribution to the Plan under section 404(a) of the Code. Company P proposes to take this deduction for the Contribution for its Fiscal year, which ended January 31, .

Based on the facts and representations, you request the following rulings:

1. Whether the Pension Plan's current liability for purposes of determining the deductible limit under section 404(a)(1)(D)(i) of the Code should include an adjustment of the full plan year unit-credit normal cost (using assumptions used for valuing current liability) or only a portion of such normal cost prorated on the length of time from the valuation date within the fiscal year to the end of the fiscal year; and,

2. Whether the interest adjustment for both the determination of expected assets and expected current liability should be calculated to the end of the tax year.

Section 404(a) of the Code provides, as a general rule, that if contributions paid by an employer on account of any employee to a pension, profit sharing or annuity plan would otherwise be deductible, they shall be deductible under section 404 of the Code, subject to certain limitations set forth therein on the amounts deductible in any year. Section 404(a)(1)(A) of the Code provides limits on the deductibility of contributions with respect to qualified defined benefit plans.

Section 404(a)(1)(D)(i) of the Code provides that, in the case of a defined benefit plan, the maximum amount deductible under the limitations of section 404(a)(1) shall not be less then the unfunded current liability determined under section 412(l). The term "unfunded current liability" is defined in section 412(l)(8)(A) of the Code, with respect to any plan year as the excess (if any) of - (i) the current liability under the plan, over (ii) the value of the plan's assets determined on the basis of any reasonable actuarial method of valuation which takes into account fair market value and which is permitted under the Treasury Regulations ("Regulations").

Section 404(a)(1)(D)(iv) of the Code provides that, in the case of a plan which, subject to section 4041 of the Employee Retirement Income Security Act of 1974, terminates during the plan year, section 404(a)(1)(D)(i) of the Code shall be applied by substituting for unfunded current liability the amount required to make the plan sufficient for benefit liabilities (within the meaning of section 4041(d) of such Act).

Section 1.404(a)-14 of the Regulations provides guidance for the determination of the deductible limits under section 404 of the Code for defined benefit plans.

Section 1.404(a)-14(c) of the Regulations provides that although the deductible limit of section 404 of the Code applies for an employer's taxable year, the deductible limit is determined on the basis of a plan year. If an employer's taxable year coincides with the plan year, the deductible limit for the taxable year is the deductible limit for the plan year that coincides with that year. If the employer's taxable year does not coincide with the plan year, the deductible limit under section 404 of the Code for a given taxable year is one of the following three alternatives: (i) the deductible limit for the plan year commencing within the employer's taxable year; (ii) the deductible limit for the plan year ending within the employer's taxable year; or (iii) a weighted average of alternatives (i) and (ii).

Under section 1.404(a)-14(f)(3) of the Regulations, the deductible limit for a defined benefit plan is determined for a plan year based upon the computation date. Generally, the computation date is the valuation date for the actuarial valuation for the plan year. Once the deductible limit is determined as of the computation date, the limit is increased with interest to the earlier of the end of the plan year or the end of the tax year.

Section 412(c)(7)(A)(i) of the Code defines the term "full-funding limitation" as the excess (if any) of (i) the lesser of (I) in the case of plan years beginning before January 1, 2004, the applicable percentage of current liability (including the expected increase in current liability due to benefits accruing during the plan year), or (II) the accrued liability (including normal cost) under the plan (determined under the entry age normal funding method if such accrued liability cannot be directly calculated under the funding method used for the plan), over (ii) the lesser of(I) the fair market value of the plan's assets, or (II) the value of such assets determined under paragraph (2). Section 412(l)(7) of the Code defines "current liability" as all liabilities to employees and their beneficiaries under the plan.

Revenue Ruling 82-125, 1982-1 C.B. 64, provides examples of the determination of the full funding limitation. Revenue Ruling 82-125 also provides guidance on how the full funding limitation affects the maximum tax deductible contribution to a defined benefit plan when the plan year and tax year of the plan sponsor do not coincide. Under Revenue Ruling 82-125 for purposes of section 404 of the Code, the full funding limitation is determined as the excess of (A) the sum of the accrued liability plus the normal cost determined as of the valuation date and increased with interest to the end of the plan year, over (B) the lesser of the fair market value or the actuarial value of the assets as of the valuation date increased with interest to the end of the plan year (with a further adjustment of then subtracting any contribution carryover without an interest adjustment).

Other uses of current liability in sections 404 and 412 of the Code (the determination of the full funding limitation) include the expected increase in current liability due to benefits accruing during the plan year. Therefore, it would be inconsistent to include that amount for other purposes and yet exclude the expected increase in current liability due to benefits accruing during the plan year for purposes of section 404(a)(1)(D) of the Code. Clearly, the congressional intent of section 404(a)(1)(D)(i) is to allow employers to make large enough contributions to a plan to adequately fund the plan for current liability.

For example, prior to the enactment of Public Law ("P.L.") 107-16 section 652(a), section 404(a)(1)(D) of the Code allowed an employer that sponsored a single employer defined benefit pension plan which had more than 100 participants for the plan year to deduct amounts contributed of up to 100 percent of the plan's unfunded current liability. P.L. 107-16 section 652(a) added sections 404(a)(1)(D)(i) through (iv) of the Code to expand the special rules to give more plan sponsors incentives to adequately fund their plan.

In regard to your first ruling request, we conclude that the expected increase in current liability due to benefits accruing during the plan year should be added to the current liability in determining the deductible limit under section 404(a)(1)(D)(i) of the Code. In response to your second ruling request we conclude that the interest adjustment for both the determination of expected assets and expected current liability should be calculated to the end of the tax year.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent. A copy of this letter is being sent to your authorized representative in accordance with a power of attorney on file in this office.

If you wish to inquire about this ruling, please contact * * *, I.D. # * * *, at * * *. Please address all correspondence to SE:T:EP:RA:T3.

Sincerely yours,

Frances V Sloan

Frances V. Sloan, Manager
Employee Plans Technical Group 3

Enclosures: Deleted copy of this letter
Notice of Intention to Disclose, Notice 437

cc: * * *
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