DESCRIPTION OF THE CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 10, THE "COMPREHENSIVE RETIREMENT SECURITY AND PENSION REFORM ACT OF 2001"

Scheduled for Markup

By the

HOUSE COMMITTEE ON WAYS AND MEANS

on April 25, 2001

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of the

JOINT COMMITTEE ON TAXATION

April 24, 2001

JCX-25-01

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INTRODUCTION

The House Committee on Ways and Means has scheduled a markup for April 25, 2001, on the provisions of H.R. 10, the "Comprehensive Retirement Security and Pension Reform Act of 2001."

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of present law and the provisions of a Chairman's amendment in the nature of a substitute to the provisions of H.R. 10.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Amendment in the Nature of a Substitute to H.R. 10, the "Comprehensive Retirement Security and Pension Reform Act of 2001"* (JCX-25-01), April 24, 2001.

I. INDIVIDUAL RETIREMENT ARRANGEMENTS ("IRAS")

Present Law

In general

There are two general types of individual retirement arrangements ("IRAs") under present law: traditional IRAs, to which both deductible and nondeductible contributions may be made, and Roth IRAs. The Federal income tax rules regarding each type of IRA (and IRA contribution) differ.

Traditional IRAs

Under present law, an individual may make deductible contributions to an IRA up to the lesser of $2,000 or the individual's compensation if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan. In the case of a married couple, deductible IRA contributions of up to $2,000 can be made for each spouse (including, for example, a homemaker who does not work outside the home), if the combined compensation of both spouses is at least equal to the contributed amount. If the individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan, the $2,000 deduction limit is phased out for taxpayers with adjusted gross income ("AGI") over certain levels for the taxable year.

The AGI phase-out limits for taxpayers who are active participants in employer-sponsored plans are as follows.

Single Taxpayers

Taxable years beginning in:	*Phase-out range*
2001	33,000-43,000
2002	34,000-44,000
2003	40,000-50,000
2004	45,000-55,000
2005 and thereafter	50,000-60,000

Joint Returns

Taxable years beginning in:	*Phase-out range*
2000	53,000-63,000
2002	54,000-64,000
2003	60,000-70,000
2004	65,000-75,000
2005	70,000-80,000
2006	75,000-85,000
2007 and thereafter	80,000-100,000

The AGI phase-out range for married taxpayers filing a separate return is $0 to $10,000.

If the individual is not an active participant in an employer-sponsored retirement plan, but the individual's spouse is, the $2,000 deduction limit is phased out for taxpayers with AGI between $150,000 and $160,000.

To the extent an individual cannot or does not make deductible contributions to an IRA or contributions to a Roth IRA, the individual may make nondeductible contributions to a traditional IRA.

Amounts held in a traditional IRA are includible in income when withdrawn (except to the extent the withdrawal is a return of nondeductible contributions). Includible amounts withdrawn prior to attainment of age 59-1/2 are subject to an additional 10-percent early withdrawal tax, unless the withdrawal is due to death or disability, is made in the form of certain periodic payments, is used to pay medical expenses in excess of 7.5 percent of AGI, is used to purchase health insurance of an unemployed individual, is used for education expenses, or is used for first-time homebuyer expenses of up to $10,000.

Roth IRAs

Individuals with AGI below certain levels may make nondeductible contributions to a Roth IRA. The maximum annual contribution that may be made to a Roth IRA is the lesser of $2,000 or the individual's compensation for the year. The contribution limit is reduced to the extent an individual makes contributions to any other IRA for the same taxable year. As under the rules relating to IRAs generally, a contribution of up to $2,000 for each spouse may be made to a Roth IRA provided the combined compensation of the spouses is at least equal to the contributed amount. The maximum annual contribution that can be made to a Roth IRA is phased out for single individuals with AGI between $95,000 and $110,000 and for joint filers with AGI between $150,000 and $160,000.

Taxpayers with modified AGI of $100,000 or less generally may convert a traditional IRA into a Roth IRA. The amount converted is includible in income as if a withdrawal had been made, except that the 10-percent early withdrawal tax does not apply and, if the conversion occurred in 1998, the income inclusion may be spread ratably over 4 years. Married taxpayers who file separate returns cannot convert a traditional IRA into a Roth IRA.

Amounts held in a Roth IRA that are withdrawn as a qualified distribution are not includible in income, or subject to the additional 10-percent tax on early withdrawals. A qualified distribution is a distribution that (1) is made after the 5-taxable year period beginning with the first taxable year for which the individual made a contribution to a Roth IRA, and (2) which is made after attainment of age 59-1/2, on account of death or disability, or is made for first-time homebuyer expenses of up to $10,000.

Distributions from a Roth IRA that are not qualified distributions are includible in income to the extent attributable to earnings, and subject to the 10-percent early withdrawal tax (unless an exception applies).[2] The same exceptions to the early withdrawal tax that apply to IRAs apply to Roth IRAs.

Description of Proposal

Increase in annual contribution limits

The proposal would increase the maximum annual dollar contribution limit for IRA contributions from $2,000 to $3,000 in 2002, $4,000 in 2003, and $5,000 in 2004. The limit would be indexed in $500 increments in 2005 and thereafter.

Additional catch-up contributions

The proposal would accelerate the increase of the IRA maximum contribution limit for individuals who have attained age 50 before the end of the taxable year. The maximum dollar contribution limit (before application of the AGI phase-out limits) for such an individual would be increased to $5,000 in 2002, 2003, and 2004, and would be indexed in $500 increments in 2005 and thereafter, under the general rule.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 2001.

[2] Early distribution of converted amounts may also accelerate income inclusion of converted amounts that are taxable under the 4-year rule applicable to 1998 conversions.

II. PENSION PROVISIONS

A. Expanding Coverage

1. Increase in benefit and contribution limits

Present Law

In general

Under present law, limits apply to contributions and benefits under qualified plans (sec. 415), the amount of compensation that may be taken into account under a plan for determining benefits (sec. 401(a)(17)), the maximum amount of elective deferrals that an individual may make to a salary reduction plan or tax sheltered annuity (sec. 402(g)), and deferrals under an eligible deferred compensation plan of a tax-exempt organization or a State or local government (sec. 457).

Limitations on contributions and benefits

Under present law, the limits on contributions and benefits under qualified plans are based on the type of plan. Under a defined contribution plan, the qualification rules limit the annual additions to the plan with respect to each plan participant to the lesser of (1) 25 percent of compensation or (2) $35,000 (for 2001). Annual additions are the sum of employer contributions, employee contributions, and forfeitures with respect to an individual under all defined contribution plans of the same employer. The $35,000 limit is indexed for cost-of-living adjustments in $5,000 increments.

Under a defined benefit plan, the maximum annual benefit payable at retirement is generally the lesser of (1) 100 percent of average compensation, or (2) $140,000 (for 2001). The dollar limit is adjusted for cost-of-living increases in $5,000 increments.

Under present law, in general, the dollar limit on annual benefits is reduced if benefits under the plan begin before the social security retirement age (currently, age 65) and increased if benefits begin after social security retirement age.

Compensation limitation

Under present law, the annual compensation of each participant that may be taken into account for purposes of determining contributions and benefits under a plan, applying the deduction rules, and for nondiscrimination testing purposes is limited to $170,000 (for 2001). The compensation limit is indexed for cost-of-living adjustments in $10,000 increments.

Elective deferral limitations

Under present law, under certain salary reduction arrangements, an employee may elect to have the employer make payments as contributions to a plan on behalf of the employee, or to the employee directly in cash. Contributions made at the election of the employee are called elective deferrals.

The maximum annual amount of elective deferrals that an individual may make to a qualified cash or deferred arrangement (a "section 401(k) plan"), a tax-sheltered annuity ("section 403(b) annuity") or a salary reduction simplified employee pension plan ("SEP") is $10,500 (for 2001). The maximum annual amount of elective deferrals that an individual may make to a SIMPLE plan is $6,500 (for 2001). These limits are indexed for inflation in $500 increments.

Section 457 plans

The maximum annual deferral under a deferred compensation plan of a State or local government or a tax-exempt organization (a "section 457 plan") is the lesser of (1) $8,500 (for 2001) or (2) 33-1/3 percent of compensation. The $8,500 dollar limit is increased for inflation in $500 increments. Under a special catch-up rule, the section 457 plan may provide that, for one or more of the participant's last 3 years before retirement, the otherwise applicable limit is increased to the lesser of (1) $15,000 or (2) the sum of the otherwise applicable limit for the year plus the amount by which the limit applicable in preceding years of participation exceeded the deferrals for that year.

Description of Proposal

Limits on contributions and benefits

The proposal would increase the $35,000 limit on annual additions to a defined contribution plan to $40,000. This amount would be indexed in $1,000 increments.[3]

The proposal would increase the $140,000 annual benefit limit under a defined benefit plan to $160,000. The dollar limit would be reduced for benefit commencement before age 62 and increased for benefit commencement after age 65.

Compensation limitation

The proposal would increase the limit on compensation that may be taken into account under a plan to $200,000. This amount would be indexed in $5,000 increments.

Elective deferral limitations

In 2002, the proposal would increase the dollar limit on annual elective deferrals under section 401(k) plans, section 403(b) annuities and salary reduction SEPs to $11,000. In 2003 and thereafter, the limits would increase in $1,000 annual increments until the limits reach $15,000 in 2006, with indexing in $500 increments thereafter. In 2002, the proposal would increase the maximum annual elective deferrals that may be made to a SIMPLE plan to $7,000. In 2003 and

[3] The 25 percent of compensation limitation would be increased to 100 percent of compensation under another provision of the proposal.

thereafter, the SIMPLE plan deferral limit would increase in $1,000 annual increments until the limit reaches $10,000 in 2005. Beginning after 2005, the $10,000 dollar limit would be indexed in $500 increments.

Section 457 plans

The proposal would increase the dollar limit on deferrals under a section 457 plan to conform to the elective deferral limitation. Thus, the limit would be $11,000 in 2002, and would be increased in $1,000 annual increments thereafter until the limit reaches $15,000 in 2006. The limit would be indexed thereafter in $500 increments. The limit would be twice the otherwise applicable dollar limit in the three years prior to retirement.[4]

Effective Date

The proposal would be effective for years beginning after December 31, 2001.

2. Plan loans for subchapter S shareholders, partners, and sole proprietors

Present Law

The Internal Revenue Code prohibits certain transactions ("prohibited transactions") between a qualified plan and a disqualified person in order to prevent persons with a close relationship to the qualified plan from using that relationship to the detriment of plan participants and beneficiaries.[5] Certain types of transactions are exempted from the prohibited transaction rules, including loans from the plan to plan participants, if certain requirements are satisfied. In addition, the Secretary of Labor can grant an administrative exemption from the prohibited transaction rules if she finds the exemption is administratively feasible, in the interest of the plan and plan participants and beneficiaries, and protective of the rights of participants and beneficiaries of the plan. Pursuant to this exemption process, the Secretary of Labor grants exemptions both with respect to specific transactions and classes of transactions.

The statutory exemptions to the prohibited transaction rules do not apply to certain transactions in which the plan makes a loan to an owner-employee.[6] Loans to participants other than owner-employees are permitted if loans are available to all participants on a reasonably equivalent basis, are not made available to highly compensated employees in an amount greater than made available to other employees, are made in accordance with specific provisions in the plan, bear a reasonable rate of interest, and are adequately secured. In addition, the Code places limits on the amount of loans and repayment terms.

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[4] Another proposal would increase the 33-1/3 percentage of compensation limit to 100 percent.

[5] Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), also contains prohibited transaction rules. The Code and ERISA provisions are substantially similar, although not identical.

[6] Certain transactions involving a plan and Subchapter S shareholders are permitted.

For purposes of the prohibited transaction rules, an owner-employee means (1) a sole proprietor, (2) a partner who owns more than 10 percent of either the capital interest or the profits interest in the partnership, (3) an employee or officer of a Subchapter S corporation who owns more than 5 percent of the outstanding stock of the corporation, and (4) the owner of an individual retirement arrangement ("IRA"). The term owner-employee also includes certain family members of an owner-employee and certain corporations owned by an owner-employee.

Under the Internal Revenue Code, a two-tier excise tax is imposed on disqualified persons who engage in a prohibited transaction. The first level tax is equal to 15 percent of the amount involved in the transaction. The second level tax is imposed if the prohibited transaction is not corrected within a certain period, and is equal to 100 percent of the amount involved.

Description of Proposal

The proposal generally would eliminate the special present-law rules relating to plan loans made to an owner-employee (other than the owner of an IRA). Thus, the general statutory exemption would apply to such transactions. Present law would continue to apply with respect to IRAs.

Effective Date

The proposal would be effective with respect to years beginning after December 31, 2001.

3. Modification of top-heavy rules

Present Law

In general

Under present law, additional qualification requirements apply to plans that primarily benefit an employer's key employees ("top-heavy plans"). These additional requirements provide (1) more rapid vesting for plan participants who are non-key employees and (2) minimum nonintegrated employer contributions or benefits for plan participants who are non-key employees.

Definition of top-heavy plan

In general, a top-heavy plan is a plan under which more than 60 percent of the contributions or benefits are provided to key employees. More precisely, a defined benefit plan is a top-heavy plan if more than 60 percent of the cumulative accrued benefits under the plan are for key employees. A defined contribution plan is top heavy if the sum of the account balances of key employees is more than 60 percent of the total account balances under the plan. For each plan year, the determination of top-heavy status generally is made as of the last day of the preceding plan year ("the determination date").

For purposes of determining whether a plan is a top-heavy plan, benefits derived both from employer and employee contributions, including employee elective contributions, are taken into account. In addition, the accrued benefit of a participant in a defined benefit plan and the account balance of a participant in a defined contribution plan includes any amount distributed within the 5-year period ending on the determination date.

An individual's accrued benefit or account balance is not taken into account in determining whether a plan is top-heavy if the individual has not performed services for the employer during the 5-year period ending on the determination date.

In some cases, two or more plans of a single employer must be aggregated for purposes of determining whether the group of plans is top-heavy. The following plans must be aggregated: (1) plans which cover a key employee (including collectively bargained plans); and (2) any plan upon which a plan covering a key employee depends for purposes of satisfying the Code's nondiscrimination rules. The employer may be required to include terminated plans in the required aggregation group. In some circumstances, an employer may elect to aggregate plans for purposes of determining whether they are top heavy.

SIMPLE plans are not subject to the top-heavy rules.

Definition of key employee

A key employee is an employee who, during the plan year that ends on the determination date or any of the 4 preceding plan years, is (1) an officer earning over one-half of the defined benefit plan dollar limitation of section 415 ($70,000 for 2001), (2) a 5-percent owner of the employer, (3) a 1-percent owner of the employer earning over $150,000, or (4) one of the 10 employees earning more than the defined contribution plan dollar limit ($35,000 for 2001) with the largest ownership interests in the employer. A family ownership attribution rule applies to the determination of 1-percent owner status, 5-percent owner status, and largest ownership interest. Under this attribution rule, an individual is treated as owning stock owned by the individual's spouse, children, grandchildren, or parents.

Minimum benefit for non-key employees

A minimum benefit generally must be provided to all non-key employees in a top-heavy plan. In general, a top-heavy defined benefit plan must provide a minimum benefit equal to the lesser of (1) 2 percent of compensation multiplied by the employee's years of service, or (2) 20 percent of compensation. A top-heavy defined contribution plan must provide a minimum annual contribution equal to the lesser of (1) 3 percent of compensation, or (2) the percentage of compensation at which contributions were made for key employees (including employee elective contributions made by key employees and employer matching contributions).

For purposes of the minimum benefit rules, only benefits derived from employer contributions (other than amounts employees have elected to defer) to the plan are taken into account, and an employee's social security benefits are disregarded (i.e., the minimum benefit is nonintegrated). Employer matching contributions may be used to satisfy the minimum contribution requirement; however, in such a case the contributions are not treated as matching contributions for purposes of applying the special nondiscrimination requirements applicable to employee elective contributions and matching contributions under sections 401(k) and (m). Thus, such contributions would have to meet the general nondiscrimination test of section 401(a)(4).[7]

Top-heavy vesting

Benefits under a top-heavy plan must vest at least as rapidly as under one of the following schedules: (1) 3-year cliff vesting, which provides for 100 percent vesting after 3 years of service; and (2) 2-6 year graduated vesting, which provides for 20 percent vesting after 2 years of service, and 20 percent more each year thereafter so that a participant is fully vested after 6 years of service.[8]

Qualified cash or deferred arrangements

Under a qualified cash or deferred arrangement (a "section 401(k) plan"), an employee may elect to have the employer make payments as contributions to a qualified plan on behalf of the employee, or to the employee directly in cash. Contributions made at the election of the employee are called elective deferrals. A special nondiscrimination test applies to elective deferrals under cash or deferred arrangements, which compares the elective deferrals of highly compensated employees with elective deferrals of nonhighly compensated employees. (This test is called the actual deferral percentage test or the "ADP" test). Employer matching contributions under qualified defined contribution plans are also subject to a similar nondiscrimination test. (This test is called the actual contribution percentage test or the "ACP" test.)

Under a design-based safe harbor, a cash or deferred arrangement is deemed to satisfy the ADP test if the plan satisfies one of two contribution requirements and satisfies a notice requirement. A plan satisfies the contribution requirement under the safe harbor rule for qualified cash or deferred arrangements if the employer either (1) satisfies a matching contribution requirement or (2) makes a nonelective contribution to a defined contribution plan of at least 3 percent of an employee's compensation on behalf of each nonhighly compensated employee who is eligible to participate in the arrangement without regard to the permitted disparity rules (sec. 401(1)). A plan satisfies the matching contribution requirement if, under the arrangement: (1) the employer makes a matching contribution on behalf of each nonhighly compensated employee that is equal to (a) 100 percent of the employee's elective deferrals up to 3 percent of compensation and (b) 50 percent of the employee's elective deferrals from 3 to 5 percent of compensation; and (2), the rate of match with respect to any elective contribution for highly compensated employees is not greater than the rate of match for nonhighly compensated employees. Matching contributions that satisfy the design-based safe harbor for cash or deferred

[7] Treas. Reg. sec. 1.416-1 Q&A M-19.

[8] Benefits under a plan that is not top heavy must vest at least as rapidly as under one of the following schedules: (1) 5-year cliff vesting; and (2) 3-7 year graded vesting, which provides for 20 percent vesting after 3 years and 20 percent more each year thereafter so that a participant is fully vested after 7 years of service.

arrangements are deemed to satisfy the ACP test. Certain additional matching contributions are also deemed to satisfy the ACP test.

Description of Proposal

Definition of top-heavy plan

The proposal would provide that a plan consisting of a cash-or-deferred arrangement that satisfies the design-based safe harbor for such plans and matching contributions that satisfy the safe harbor rule for such contributions is not a top-heavy plan. Matching or nonelective contributions provided under such a plan could be taken into account in satisfying the minimum contribution requirements applicable to top-heavy plans.[9]

In determining whether a plan is top-heavy, the proposal would provide that distributions during the year ending on the date the top-heavy determination is being made are taken into account. The present-law 5-year rule would apply with respect to in-service distributions. Similarly, the proposal would provide that an individual's accrued benefit or account balance is not taken into account if the individual has not performed services for the employer during the 1-year period ending on the date the top-heavy determination is being made.

Definition of key employee

The proposal would (1) provide that an employee is not considered a key employee by reason of officer status unless the employee earns more than $150,000 and (2) repeal the top-10 owner key employee category. The proposal would repeal the 4-year lookback rule for determining key employee status and provide that an employee is a key employee only if he or she is a key employee during the preceding plan year.

Thus, under the proposal, an employee would be considered a key employee if, during the prior year, the employee was (1) an officer with compensation in excess of $150,000, (2) a 5-percent owner, or (3) a 1-percent owner with compensation in excess of $150,000. The present-law limits on the number of officers treated as key employees under (1) would continue to apply.

The family ownership attribution rule no longer would apply in determining whether an individual is a 5-percent owner of the employer for purposes of the top-heavy rules only.

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[9] This proposal would not be intended to preclude the use of nonelective contributions that are used to satisfy the safe harbor rules from being used to satisfy other qualified retirement plan nondiscrimination rules, including those involving cross-testing.

Minimum benefit for nonkey employees

Under the proposal, matching contributions would be taken into account in determining whether the minimum benefit requirement has been satisfied.[10]

The proposal would provide that, in determining the minimum benefit required under a defined benefit plan, a year of service would not include any year in which no key employee or former key employee benefits under the plan (as determined under sec. 410).

Effective Date

The proposal would be effective for years beginning after December 31, 2001.

4. Elective deferrals not taken into account for purposes of deduction limits

Present Law

Employer contributions to one or more qualified retirement plans are deductible subject to certain limits. In general, the deduction limit depends on the kind of plan.

In the case of a defined benefit pension plan or a money purchase pension plan, the employer generally may deduct the amount necessary to satisfy the minimum funding cost of the plan for the year. If a defined benefit pension plan has more than 100 participants, the maximum amount deductible is at least equal to the plan's unfunded current liabilities.

In the case of a profit-sharing or stock bonus plan, the employer generally may deduct an amount equal to 15 percent of compensation of the employees covered by the plan for the year.

If an employer sponsors both a defined benefit pension plan and a defined contribution plan that covers some of the same employees (or a money purchase pension plan and another kind of defined contribution plan), the total deduction for all plans for a plan year generally is limited to the greater of (1) 25 percent of compensation or (2) the contribution necessary to meet the minimum funding requirements of the defined benefit pension plan for the year (or the amount of the plan's unfunded current liabilities, in the case of a plan with more than 100 participants).

For purposes of the deduction limits, employee elective deferral contributions to a section 401(k) plan are treated as employer contributions and, thus, are subject to the generally applicable deduction limits.

Subject to certain exceptions, nondeductible contributions are subject to a 10-percent excise tax.

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[10] Thus, this proposal would override the provision in Treasury regulations that, if matching contributions are used to satisfy the minimum benefit requirement, then they are not treated as matching contributions for purposes of the section 401(m) nondiscrimination rules.

Description of Proposal

Under the proposal, elective deferral contributions would not be subject to the deduction limits, and the application of a deduction limitation to any other employer contribution to a qualified retirement plan would not take into account elective deferral contributions.

Effective Date

The proposal would be effective for years beginning after December 31, 2001.

5. Repeal of coordination requirements for deferred compensation plans of State and local governments and tax-exempt organizations

Present Law

Compensation deferred under an eligible deferred compensation plan of a tax-exempt or State and local government employer (a "section 457 plan") is not includible in gross income until paid or made available. In general, the maximum permitted annual deferral under such a plan is the lesser of (1) $8,500 (in 2001) or (2) 33-1/3 percent of compensation. The $8,500 limit is increased for inflation in $500 increments. Under a special catch-up rule, a section 457 plan may provide that, for one or more of the participant's last 3 years before retirement, the otherwise applicable limit is increased to the lesser of (1) $15,000 or (2) the sum of the otherwise applicable limit for the year plus the amount by which the limit applicable in preceding years of participation exceeded the deferrals for that year.

The $8,500 limit (as modified under the catch-up rule), applies to all deferrals under all section 457 plans in which the individual participates. In addition, in applying the $8,500 limit, contributions under a tax-sheltered annuity ("section 403(b) annuity"), elective deferrals under a qualified cash or deferred arrangement ("section 401(k) plan"), salary reduction contributions under a simplified employee pension plan ("SEP"), and contributions under a SIMPLE plan are taken into account. Further, the amount deferred under a section 457 plan is taken into account in applying a special catch-up rule for section 403(b) annuities.

Description of Proposal

The proposal would repeal the rules coordinating the section 457 dollar limit with contributions under other types of plans.[11]

Effective Date

The proposal would be effective for years beginning after December 31, 2001.

[11] The limits on deferrals under a section 457 plan would be modified under other provisions of the proposal.

6. Eliminate IRS user fees for certain determination letter requests regarding employer plans

Present Law

An employer that maintains a retirement plan for the benefit of its employees may request from the Internal Revenue Service ("IRS") a determination as to whether the form of the plan satisfies the requirements applicable to tax-qualified plans (sec. 401(a)). In order to obtain from the IRS a determination letter on the qualified status of the plan, the employer must pay a user fee. The user fee may range from $125 to $1,250, depending upon the scope of the request and the type and format of the plan. [12]

Present law provides that plans that do not meet the qualification requirements will be treated as meeting such requirements if appropriate retroactive plan amendments are made during the remedial amendment period. In general, the remedial amendment period ends on the due date for the employer's tax return (including extensions) for the taxable year in which the event giving rise to the disqualifying provision occurred (e.g., a plan amendment or a change in the law). The Secretary may provide for general extensions of the remedial amendment period or for extensions in certain cases. For example, the remedial amendment period with respect to amendments relating to the qualification requirements affected by the General Agreements on Tariffs and Trade, the Uniformed Services Employment and Reemployment Rights Act of 1994, the Small Business Job Protection Act of 1996, the Taxpayer Relief Act of 1997, and the Internal Revenue Service Restructuring and Reform Act of 1998 generally ends the last day of the first plan year beginning on or after January 1, 2001.[13]

Description of Proposal

A small employer (100 or fewer employees) would not be required to pay a user fee for a determination letter request with respect to the qualified status of a retirement plan that the employer maintains if the request is made before the later of (1) the last day of the fifth plan year of the plan or (2) the end of any applicable remedial amendment period with respect to the plan that begins before the end of the fifth plan year of the plan. In addition, determination letter requests for which user fees would not be required under the proposal would not be taken into account in determining average user fees. The proposal would apply only to requests by employers for determination letters concerning the qualified retirement plans they maintain. Therefore, a sponsor of a prototype plan would be required to pay a user fee for a request for a notification letter, opinion letter, or similar ruling. A small employer that adopts a prototype plan, however, would not be required to pay a user fee for a determination letter request with respect to the employer's plan.

[12] User fees are statutorily authorized; however, the IRS sets the dollar amount of the fee applicable to any particular type of request.

[13] Rev. Proc. 2000-27, 2000-26 I.R.B. 1272.

Effective Date

The proposal would be effective for determination letter requests made after December 31, 2001.

7. Deduction limits

Present Law

Employer contributions to one or more qualified retirement plans are deductible subject to certain limits. In general, the deduction limit depends on the kind of plan. Subject to certain exceptions, nondeductible contributions are subject to a 10-percent excise tax.

In the case of a defined benefit pension plan or a money purchase pension plan, the employer generally may deduct the amount necessary to satisfy the minimum funding cost of the plan for the year. If a defined benefit pension plan has more than 100 participants, the maximum amount deductible is at least equal to the plan's unfunded current liabilities.

In some cases, the amount of deductible contributions is limited by compensation. In the case of a profit-sharing or stock bonus plan, the employer generally may deduct an amount equal to 15 percent of compensation of the employees covered by the plan for the year.

If an employer sponsors both a defined benefit pension plan and a defined contribution plan that covers some of the same employees (or a money purchase pension plan and another kind of defined contribution plan), the total deduction for all plans for a plan year generally is limited to the greater of (1) 25 percent of compensation or (2) the contribution necessary to meet the minimum funding requirements of the defined benefit pension plan for the year (or the amount of the plan's unfunded current liabilities, in the case of a plan with more than 100 participants).

In the case of an employee stock ownership plan ("ESOP"), principal payments on a loan used to acquire qualifying employer securities are deductible up to 25 percent of compensation.

For purposes of the deduction limits, employee elective deferral contributions to a qualified cash or deferred arrangement ("section 401(k) plan") are treated as employer contributions and, thus, are subject to the generally applicable deduction limits.[14]

For purposes of the deduction limits, compensation means the compensation otherwise paid or accrued during the taxable year to the beneficiaries under the plan, and the beneficiaries under a profit-sharing or stock bonus plan are the employees who benefit under the plan with respect to the employer's contribution.[15] An employee who is eligible to make elective deferrals

[14] Another proposal would provide that elective deferrals are not subject to the deduction limits.

[15] Rev. Rul. 65-295, 1965-2 C.B. 148.

under a section 401(k) plan is treated as benefitting under the arrangement even if the employee elects not to defer.[16]

For purposes of the deduction rules, compensation generally includes only taxable compensation, and thus does not include salary reduction amounts, such as elective deferrals under a section 401(k) plan or a tax-sheltered annuity ("section 403(b) annuity"), elective contributions under a deferred compensation plan of a tax-exempt organization or a State or local government ("section 457 plan"), and salary reduction contributions under a section 125 cafeteria plan. For purposes of the contribution limits under section 415, compensation does include such salary reduction amounts.

Description of Proposal

Under the proposal, the definition of compensation for purposes of the deduction rules would include salary reduction amounts treated as compensation under section 415. In addition, the annual limitation on the amount of deductible contributions to a profit-sharing or stock bonus plan would be increased from 15 percent to 20 percent of compensation of the employees covered by the plan for the year.

Effective Date

The proposal would be effective for years beginning after December 31, 2001.

8. Option to treat elective deferrals as after-tax contributions

Present Law

A qualified cash or deferred arrangement ("section 401(k) plan") or a tax-sheltered annuity ("section 403(b) annuity") may permit a participant to elect to have the employer make payments as contributions to the plan or to the participant directly in cash. Contributions made to the plan at the election of a participant are elective deferrals. Elective deferrals must be nonforfeitable and are subject to an annual dollar limitation (sec. 402(g)) and distribution restrictions. In addition, elective deferrals under a section 401(k) plan are subject to special nondiscrimination rules. Elective deferrals (and earnings attributable thereto) are not includible in a participant's gross income until distributed from the plan.

Elective deferrals for a taxable year that exceed the annual dollar limitation ("excess deferrals") are includible in gross income for the taxable year. If an employee makes elective deferrals under a plan (or plans) of a single employer that exceed the annual dollar limitation ("excess deferrals"), then the plan may provide for the distribution of the excess deferrals, with earnings thereon. If the excess deferrals are made to more than one plan of unrelated employers, then the plan may permit the individual to allocate excess deferrals among the various plans, no later than the March 1 (April 15 under the applicable regulations) following the end of the taxable year. If excess deferrals are distributed not later than April 15 following the end of the taxable year, along with earnings attributable to the excess deferrals, then the excess deferrals are

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[16] Treas. Reg. sec. 1.410(b)-3.

not again includible in income when distributed. The earnings are includible in income in the year distributed. If excess deferrals (and income thereon) are not distributed by the applicable April 15, then the excess deferrals (and income thereon) are includible in income when received by the participant. Thus, excess deferrals that are not distributed by the applicable April 15th are taxable both in the taxable year when the deferral was made and in the year the participant receives a distribution of the excess deferral.

Individuals with adjusted gross income below certain levels generally may make nondeductible contributions to a Roth IRA and may convert a deductible or nondeductible IRA into a Roth IRA. Amounts held in a Roth IRA that are withdrawn as a qualified distribution are not includible in income, nor subject to the additional 10-percent tax on early withdrawals. A qualified distribution is a distribution that (1) is made after the 5-taxable year period beginning with the first taxable year for which the individual made a contribution to a Roth IRA, and (2) is made after attainment of age 59-1/2, is made on account of death or disability, or is a qualified special purpose distribution (i.e., for first-time homebuyer expenses of up to $10,000). A distribution from a Roth IRA that is not a qualified distribution is includible in income to the extent attributable to earnings, and is subject to the 10-percent tax on early withdrawals (unless an exception applies).[17]

Description of Proposal

A section 401(k) plan or a section 403(b) annuity would be permitted to include a "qualified plus contribution program" that permits a participant to elect to have all or a portion of the participant's elective deferrals under the plan treated as designated plus contributions. Designated plus contributions would be elective deferrals that the participant designates (at such time and in such manner as the Secretary may prescribe)[18] as not excludable from the participant's gross income.

The annual dollar limitation on a participant's designated plus contributions would be the section 402(g) annual limitation on elective deferrals, reduced by the participant's elective deferrals that the participant does not designate as designated plus contributions. Designated plus contributions would be treated as any other elective deferral for purposes of nonforfeitability requirements and distribution restrictions.[19] Under a section 401(k) plan, designated plus contributions also would be treated as any other elective deferral for purposes of the special nondiscrimination requirements.[20]

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[17] Early distributions of converted amounts may also accelerate income inclusion of converted amounts that are taxable under the 4-year rule applicable to 1998 conversions.

[18] It would be intended that the Secretary would generally not permit retroactive designations of elective deferrals as designated plus contributions.

[19] Similarly, designated plus contributions to a section 403(b) annuity would be treated the same as other salary reduction contributions to the annuity (except that designated plus contributions would be includible in income).

[20] It would be intended that the Secretary would provide ordering rules regarding the return of excess contributions under the special nondiscrimination rules (pursuant to sec.

The plan would be required to establish a separate account, and maintain separate recordkeeping, for a participant's designated plus contributions (and earnings allocable thereto). A qualified distribution from a participant's designated plus contributions account would not be includible in the participant's gross income. A qualified distribution would be a distribution that is made after the end of a specified nonexclusion period and that is (1) made on or after the date on which the participant attains age 59-1/2, (2) made to a beneficiary (or to the estate of the participant) on or after the death of the participant, or (3) attributable to the participant's being disabled.[21] The nonexclusion period would be the 5-year-taxable period beginning with the earlier of (1) the first taxable year for which the participant made a designated plus contribution to any designated plus contribution account established for the participant under the plan, or (2) if the participant has made a rollover contribution to the designated plus contribution account that is the source of the distribution from a designated plus contribution account established for the participant under another plan, the first taxable year for which the participant made a designated plus contribution to the previously established account.

A distribution from a designated plus contributions account that is a corrective distribution of an elective deferral (and income allocable thereto) that exceeds the section 402(g) annual limit on elective deferrals or a corrective distribution of an excess contribution under the special nondiscrimination rules (pursuant to sec. 401(k)(8) (and income allocable thereto) would not be a qualified distribution. In addition, the treatment of excess designated plus contributions would be similar to the treatment of excess deferrals attributable to non-designated plus contributions. If excess designated plus contributions (including earnings thereon) are distributed no later than the April 15th following the taxable year, then the designated plus contributions would not be includible in gross income as a result of the distribution, because such contributions would be includible in gross income when made. Earnings on such excess designated plus contributions would be treated the same as earnings on excess deferrals distributed no later than April 15th, i.e., they would be includible in income when distributed. If excess designated plus contributions are not distributed no later than the applicable April 15th, then such contributions (and earnings thereon) would be taxable when distributed. Thus, as is the case with excess elective deferrals that are not distributed by the applicable April 15th, the contributions would be includible in income in the year when made and again when distributed from the plan. Earnings on such contributions would be taxable when received.

A participant would be permitted to roll over a distribution from a designated plus contributions account only to another designated plus contributions account or a Roth IRA of the participant.

The Secretary of the Treasury would be directed to require the plan administrator of each section 401(k) plan or section 403(b) annuity that permits participants to make designated plus

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401(k)(8)) in the event a participant makes both regular elective deferrals and designated plus contributions. It would be intended that such rules would generally permit a plan to allow participants to designate which contributions would be returned first or to permit the plan to specify which contributions would be returned first.

[21] A qualified special purpose distribution, as defined under the rules relating to Roth IRAs, does not qualify as a tax-free distribution from a designated plus contributions account.

contributions to make such returns and reports regarding designated plus contributions to the Secretary, plan participants and beneficiaries, and other persons that the Secretary may designate.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 2001.

B. Enhancing Fairness for Women

1. Additional salary reduction catch-up contributions

Present Law

Elective deferral limitations

Under present law, under certain salary reduction arrangements, an employee may elect to have the employer make payments as contributions to a plan on behalf of the employee, or to the employee directly in cash. Contributions made at the election of the employee are called elective deferrals.

The maximum annual amount of elective deferrals that an individual may make to a qualified cash or deferred arrangement (a "401(k) plan"), a tax-sheltered annuity ("section 403(b) annuity") or a salary reduction simplified employee pension plan ("SEP") is $10,500 (for 2001). The maximum annual amount of elective deferrals that an individual may make to a SIMPLE plan is $6,500 (for 2001). These limits are indexed for inflation in $500 increments.

Section 457 plans

The maximum annual deferral under a deferred compensation plan of a State or local government or a tax-exempt organization (a "section 457 plan") is the lesser of (1) $8,500 (for 2001) or (2) 33-1/3 percent of compensation. The $8,500 dollar limit is increased for inflation in $500 increments. Under a special catch-up rule, the section 457 plan may provide that, for one or more of the participant's last 3 years before retirement, the otherwise applicable limit is increased to the lesser of (1) $15,000 or (2) the sum of the otherwise applicable limit for the year plus the amount by which the limit applicable in preceding years of participation exceeded the deferrals for that year.

Description of Proposal

The proposal would provide that the otherwise applicable dollar limit on elective deferrals under a section 401(k) plan, section 403(b) annuity, or SIMPLE, or deferrals under a section 457 plan are increased for individuals who have attained age 50 by the end of the year.[22] Additional contributions could be made by an individual who has attained age 50 before the end

[22] Another proposal would increase the dollar limit on elective deferrals under such arrangements.

of the plan year and with respect to whom no other elective deferrals may otherwise be made to the plan for the year because of the application of any limitation of the Code (e.g., the annual limit on elective deferrals) or of the plan. Under the proposal, the additional amount of elective contributions that would be permitted to be made by an eligible individual participating in such a plan would be $5,000. This $5,000 amount would in increased for inflation in $500 increments in 2007 and thereafter.[23]

Catch-up contributions made under the proposal would not be subject to any other contribution limits and would not be taken into account in applying other contribution limits. Such contributions would be subject to applicable nondiscrimination rules. Although catch-up contributions would be subject to applicable nondiscrimination rules, a plan would not be treated as failing to meet the applicable nondiscrimination requirements under section 401(a)(4) with respect to benefits, rights, and features if the plan allows all eligible individuals participating in the plan to make the same election with respect to catch-up contributions. For purposes of this rule, all plans of related employers would be treated as a single plan.

An employer would be permitted to make matching contributions with respect to catch-up contributions. Any such matching contributions would be subject to the normally applicable rules.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 2001.

2. Equitable treatment for contributions of employees to defined contribution plans

Present Law

Present law imposes limits on the contributions that may be made to tax-favored retirement plans.

Defined contribution plans

In the case of a tax-qualified defined contribution plan, the limit on annual additions that can be made to the plan on behalf of an employee is the lesser of $35,000 (for 2001) or 25 percent of the employee's compensation (sec. 415(c)). Annual additions include employer contributions, including contributions made at the election of the employee (i.e., employee elective deferrals), after-tax employee contributions, and any forfeitures allocated to the employee. For this purpose, compensation means taxable compensation of the employee, plus elective deferrals, and similar salary reduction contributions. A separate limit applies to benefits under a defined benefit plan.

[23] In the case of a section 457 plans, this catch-up rule would not apply during the participant's last 3 years before retirement (in those years, the regularly applicable dollar limit is doubled).

For years before January 1, 2000, an overall limit applied if an employee was a participant in both a defined contribution plan and a defined benefit plan of the same employer.

Tax-sheltered annuities

In the case of a tax-sheltered annuity (a "section 403(b) annuity"), the annual contribution generally cannot exceed the lesser of the exclusion allowance or the section 415(c) defined contribution limit. The exclusion allowance for a year is equal to 20 percent of the employee's includible compensation, multiplied by the employee's years of service, minus excludable contributions for prior years under qualified plans, tax-sheltered annuities or section 457 plans of the employer.

In addition to this general rule, employees of nonprofit educational institutions, hospitals, home health service agencies, health and welfare service agencies, and churches may elect application of one of several special rules that increase the amount of the otherwise permitted contributions. The election of a special rule is irrevocable; an employee may not elect to have more than one special rule apply.

Under one special rule, in the year the employee separates from service, the employee may elect to contribute up to the exclusion allowance, without regard to the 25 percent of compensation limit under section 415. Under this rule, the exclusion allowance is determined by taking into account no more than 10 years of service.

Under a second special rule, the employee may contribute up to the lesser of: (1) the exclusion allowance; (2) 25 percent of the participant's includible compensation; or (3) $15,000.

Under a third special rule, the employee may elect to contribute up to the section 415(c) limit, without regard to the exclusion allowance. If this option is elected, then contributions to other plans of the employer are also taken into account in applying the limit.

For purposes of determining the contribution limits applicable to section 403(b) annuities, includible compensation means the amount of compensation received from the employer for the most recent period which may be counted as a year of service under the exclusion allowance. In addition, includible compensation includes elective deferrals and similar salary reduction amounts.

Treasury regulations include provisions regarding application of the exclusion allowance in cases where the employee participates in a section 403(b) annuity and a defined benefit plan. The Taxpayer Relief Act of 1997 directed the Secretary of the Treasury to revise these regulations, effective for years beginning after December 31, 1999, to reflect the repeal of the overall limit on contributions and benefits.

Section 457 plans

Compensation deferred under an eligible deferred compensation plan of a tax-exempt or State and local governmental employer (a "section 457 plan") is not includible in gross income until paid or made available. In general, the maximum permitted annual deferral under such a plan is the lesser of (1) $8,500 (in 2001) or (2) 33-1/3 percent of compensation. The $8,500 limit is increased for inflation in $500 increments.

Description of Proposal

Increase in defined contribution plan limit

The proposal would increase the 25 percent of compensation limitation on annual additions under a defined contribution plan to 100 percent.[24]

Conforming limits on tax-sheltered annuities

The proposal would repeal the exclusion allowance applicable to contributions to tax-sheltered annuities. Thus, such annuities would be subject to the limits applicable to tax-qualified plans.

The proposal also would direct the Secretary of the Treasury to revise the regulations relating to the exclusion allowance under section 403(b)(2) to render void the requirement that contributions to a defined benefit plan be treated as previously excluded amounts for purposes of the exclusion allowance. For taxable years beginning after December 31, 1999, the regulatory provisions regarding the exclusion allowance would be applied as if the requirement that contributions to a defined benefit plan be treated as previously excluded amounts for purposes of the exclusion allowance were void.

Section 457 plans

The proposal would increase the 33-1/3 percent of compensation limitation on deferrals under a section 457 plan to 100 percent of compensation.

Effective Date

The proposal generally would be effective for years beginning after December 31, 2001. The proposal regarding the regulations under section 403(b)(2) would be effective on the date of enactment.

3. Faster vesting of employer matching contributions

Present Law

Under present law, a plan is not a qualified plan unless a participant's employer-provided benefit vests at least as rapidly as under one of two alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of the participant's accrued benefit derived from employer contributions upon the completion of 5 years of service. A plan satisfies the second schedule if a participant has a nonforfeitable right to at least 20 percent of the participant's accrued benefit derived from employer contributions after

[24] Another proposal would increase the defined contribution plan dollar limit.

3 years of service, 40 percent after 4 years of service, 60 percent after 5 years of service, 80 percent after 6 years of service, and 100 percent after 7 years of service.[25]

Description of Proposal

The proposal would apply faster vesting schedules to employer matching contributions. Under the proposal, employer matching contributions would have to vest at least as rapidly as under one of the following two alternative minimum vesting schedules. A plan would satisfy the first schedule if a participant acquires a nonforfeitable right to 100 percent of employer matching contributions upon the completion of 3 years of service. A plan would satisfy the second schedule if a participant has a nonforfeitable right to 20 percent of employer matching contributions for each year of service beginning with the participant's second year of service and ending with 100 percent after 6 years of service.

Effective Date

The proposal would be effective for contributions for plan years beginning after December 31, 2001, with a delayed effective date for plans maintained pursuant to a collective bargaining agreement. The proposal would not apply to any employee until the employee has an hour of service after the effective date. In applying the new vesting schedule, service before the effective date would be taken into account.

4. Simplify and update the minimum distribution rules

Present Law

In general

Minimum distribution rules apply to all types of tax-favored retirement vehicles, including qualified plans, individual retirement arrangements ("IRAs"), tax-sheltered annuities ("section 403(b) annuities"), and eligible deferred compensation plans of tax-exempt and State and local government employers ("section 457 plans"). In general, under these rules, distribution of minimum benefits must begin no later than the required beginning date. Minimum distribution rules also apply to benefits payable with respect to a plan participant who has died. Failure to comply with the minimum distribution rules results in an excise tax imposed on the individual plan participant equal to 50 percent of the required minimum distribution not distributed for the year. The excise tax can be waived if the individual establishes to the satisfaction of the Secretary that the shortfall in the amount distributed was due to reasonable error and reasonable steps are being taken to remedy the shortfall.

Distributions prior to the death of the individual

In the case of distributions prior to the death of the plan participant, the minimum distribution rules are satisfied if either (1) the participant's entire interest in the plan is distributed by the required beginning date, or (2) the participant's interest in the plan is to be

[25] The minimum vesting requirements are also contained in Title I of ERISA.

distributed (in accordance with regulations), beginning not later than the required beginning date, over a permissible period. The permissible periods are (1) the life of the participant, (2) the lives of the participant and a designated beneficiary, (3) the life expectancy of the participant, or (4) the joint life and last survivor expectancy of the participant and a designated beneficiary. In calculating minimum required distributions, life expectancies of the participant and the participant's spouse may be recomputed annually.

In the case of qualified plans, tax-sheltered annuities, and section 457 plans, the required beginning date is the April 1 of the calendar year following the later of (1) the calendar year in which the employee attains age 70-1/2 or (2) the calendar year in which the employee retires. However, in the case of a 5-percent owner of the employer, distributions are required to begin no later than the April 1 of the calendar year following the year in which the 5-percent owner attains age 70-1/2. If commencement of benefits is delayed beyond age 70-1/2 from a defined benefit plan, then the accrued benefit of the employee must be actuarially increased to take into account the period after age 70-1/2 in which the employee was not receiving benefits under the plan.[26] In the case of distributions from an IRA other than a Roth IRA, the required beginning date is the April 1 following the calendar year in which the IRA owner attains age 70-1/2. The pre-death minimum distribution rules do not apply to Roth IRAs.

In general, under proposed regulations, in order to satisfy the minimum distribution rules, annuity payments under a defined benefit plan must be paid in period payments made at intervals not longer than one year over a permissible period, and must be nonincreasing, or increase only as a result of the following: (1) cost-of-living adjustments; (2) cash refunds of employee contributions; (3) benefit increases under the plan; or (4) an adjustment due to death of the employee's beneficiary. In the case of a defined contribution plan, the minimum required distribution is determined by dividing the employee's benefit by the applicable life expectancy.

Distributions after the death of the plan participant

The minimum distribution rules also apply to distributions to beneficiaries of deceased participants. In general, if the participant dies after minimum distributions have begun, the remaining interest must be distributed at least as rapidly as under the minimum distribution method being used as of the date of death. If the participant dies before minimum distributions have begun, then the entire remaining interest must generally be distributed within 5 years of the participant's death. The 5-year rule does not apply if distributions begin within 1 year of the participant's death and are payable over the life of a designated beneficiary or over the life expectancy of a designated beneficiary. A surviving spouse beneficiary is not required to begin distribution until the date the deceased participant would have attained age 70-1/2.

[26] State and local government plans and church plans are not required to actuarially increase benefits that begin after age 70-1/2.

Special rules for section 457 plans

Eligible deferred compensation plans of State and local and tax-exempt employers ("section 457 plans") are subject to the minimum distribution rules described above. Such plans are also subject to additional minimum distribution requirements (sec. 457(d)(2)(b)).

Description of Proposal

Modification of post-death distribution rules

The proposal would apply the present-law rules applicable if the participant dies before distribution of minimum benefits has begun to all post-death distributions. Thus, in general, if the employee dies before his or her entire interest has been distributed, distribution of the remaining interest would be required to be made within 5 years of the date of death, or begin within one year of the date of death and paid over the life or life expectancy of a designated beneficiary. In the case of a surviving spouse, distributions would not be required to begin until the surviving spouse attains age 70-1/2. Minimum distributions that have already begun would be permitted to be recalculated under the new rule.

Reduction in excise tax

The proposal would reduce the excise tax on failures to satisfy the minimum distribution rules to 10 percent of the amount that was required to be distributed but was not distributed.

Treasury regulations

The Treasury would be directed to revise the life expectancy tables under the applicable regulations to reflect current life expectancy.

Section 457 plans

The proposal would repeal the special minimum distribution rules applicable to section 457 plans. Thus, such plans would be subject to the same minimum distribution rules applicable to other types of tax-favored arrangements.

Effective Date

In general, the proposal would be effective for years beginning after December 31, 2001.

5. Clarification of tax treatment of division of section 457 plan benefits upon divorce

Present Law

Under present law, benefits provided under a qualified retirement plan for a participant may not be assigned or alienated to creditors of the participant, except in very limited circumstances. One exception to the prohibition on assignment or alienation rule is a qualified domestic relations order ("QDRO"). A QDRO is a domestic relations order that creates or recognizes a right of an alternate payee to any plan benefit payable with respect to a participant, and that meets certain procedural requirements.

Under present law, a distribution from a governmental plan or a church plan is treated as made pursuant to a QDRO if it is made pursuant to a domestic relations order that creates or recognizes a right of an alternate payee to any plan benefit payable with respect to a participant. Such distributions are not required to meet the procedural requirements that apply with respect to distributions from qualified plans.

Under present law, amounts distributed from a qualified plan generally are taxable to the participant in the year of distribution. However, if amounts are distributed to the spouse (or former spouse) of the participant by reason of a QDRO, the benefits are taxable to the spouse (or former spouse). Amounts distributed pursuant to a QDRO to an alternate payee other than the spouse (or former spouse) are taxable to the plan participant.

Section 457 of the Internal Revenue Code provides rules for deferral of compensation by an individual participating in an eligible deferred compensation plan ("section 457 plan") of a tax-exempt or State and local government employer. The QDRO rules do not apply to section 457 plans.

Description of Proposal

The proposal would apply the taxation rules for qualified plan distributions pursuant to a QDRO to distributions made pursuant to a domestic relations order from a section 457 plan. In addition, a section 457 plan would not be treated as violating the restrictions on distributions from such plans due to payments to an alternate payee under a QDRO. The special rule applicable to governmental plans and church plans would apply for purposes of determining whether a distribution is pursuant to a QDRO.

Effective Date

The proposal would be effective for transfers, distributions, and payments made after December 31, 2001.

6. Modifications relating to hardship withdrawals

Present Law

Elective deferrals under a qualified cash or deferred arrangement (a "section 401(k) plan") may not be distributable prior to the occurrence of one or more specified events. One event upon which distribution is permitted is the financial hardship of the employee. Applicable Treasury regulations[27] provide that a distribution is made on account of hardship only if the distribution is made on account of an immediate and heavy financial need of the employee and is necessary to satisfy the heavy need.

[27] Treas. Reg. sec. 1.401(k)-1.

The Treasury regulations provide a safe harbor under which a distribution may be deemed necessary to satisfy an immediate and heavy financial need. One requirement of this safe harbor is that the employee be prohibited from making elective contributions and employee contributions to the plan and all other plans maintained by the employer for at least 12 months after receipt of the hardship distribution.

Under present law, hardship withdrawals of elective deferrals from a qualified cash or deferred arrangement (or 403(b) annuity) are not eligible rollover distributions. Other types of hardship distributions, e.g., employer matching contributions distributed on account of hardship, are eligible rollover distributions. Different withholding rules apply to distributions that are eligible rollover distributions and to distributions that are not eligible rollover distributions. Eligible rollover distributions that are not directly rolled over are subject to withholding at a flat rate of 20-percent. Distributions that are not eligible rollover distributions are subject to elective withholding. Periodic distributions are subject to withholding as if the distribution were wages; nonperiodic distributions are subject to withholding at a rate of 10 percent. In either case, the individual may elect not to have withholding apply.

Description of Proposal

The Secretary of the Treasury would be directed to revise the applicable regulations to reduce from 12 months to 6 months the period during which an employee must be prohibited from making elective contributions and employee contributions in order for a distribution to be deemed necessary to satisfy an immediate and heavy financial need.

In addition, any distribution made upon hardship of an employee would not be an eligible rollover distribution. Thus, such distributions would not be permitted to be rolled over, and would be subject to the withholding rules applicable to distributions that are not eligible rollover distributions. The proposal would not modify the rules under which hardship distributions may be made. For example, as under present law, hardship distributions of qualified employer matching contributions would only be permitted under the rules applicable to elective deferrals.

The proposal would be intended to clarify that all assets distributed as a hardship withdrawal, including assets attributable to employee elective deferrals and those attributable to employer matching or nonelective contributions, would be ineligible for rollover. This rule would be intended to apply to all hardship distributions from any tax qualified plan, including those made pursuant to standards set forth in section 401(k)(2)(B)(i)(IV) (which are applicable to section 401(k) plans and section 403(b) annuities) and to those made pursuant to hardship standards set forth in any profit-sharing plan. For this purpose, a distribution that could be made either under the hardship provisions of a plan or under other provisions of the plan (such as provisions permitting in-service withdrawal of assets attributable to employer matching or nonelective contributions after a fixed period of years) could be treated as made upon hardship of the employee if the plan treats it that way. For example, if a plan makes an in-service distribution that consists of assets attributable to both elective deferrals (in circumstances where those assets could be distributed only upon hardship) and employer matching or nonelective contributions (which could be distributed in nonhardship circumstances under the plan), the plan would be permitted to treat the distribution in its entirety as made upon hardship of the employee.

Effective Date

The proposal would be effective for years beginning after December 31, 2001. The Secretary would have the authority to issue transitional guidance with respect to the proposal providing that hardship distributions are not eligible rollover distributions to provide sufficient time for plans to implement the new rule.

C. Increasing Portability for Participants

1. Rollovers of retirement plan and IRA distributions

Present Law

In general

Present law permits the rollover of funds from a tax-favored retirement plan to another tax-favored retirement plan. The rules that apply depend on the type of plan involved. Similarly, the rules regarding the tax treatment of amounts that are not rolled over depend on the type of plan involved.

Distributions from qualified plans

Under present law, an "eligible rollover distribution" from a tax-qualified employer-sponsored retirement plan may be rolled over tax free to a traditional individual retirement arrangement ("IRA")[28] or another qualified plan.[29] An "eligible rollover distribution" means any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified plan, except the term does not include (1) any distribution which is one of a series of substantially equal periodic payments made (a) for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or (b) for a specified period of 10 years or more, (2) any distribution to the extent such distribution is required under the minimum distribution rules, and (3) certain hardship distributions. The maximum amount that can be rolled over is the amount of the distribution includible in income, i.e., after-tax employee contributions cannot be rolled over. Qualified plans are not required to accept rollovers.

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[28] A "traditional" IRA refers to IRAs other than Roth IRAs or SIMPLE IRAs. All references to IRAs refer only to traditional IRAs.

[29] An eligible rollover distribution may either be rolled over by the distributee within 60 days of the date of the distribution or, as described below, directly rolled over by the distributing plan.

Distributions from tax-sheltered annuities

Eligible rollover distributions from a tax-sheltered annuity ("section 403(b) annuity") may be rolled over into an IRA or another section 403(b) annuity. Distributions from a section 403(b) annuity cannot be rolled over into a tax-qualified plan. Section 403(b) annuities are not required to accept rollovers.

IRA distributions

Distributions from a traditional IRA, other than minimum required distributions, can be rolled over into another IRA. In general, distributions from an IRA cannot be rolled over into a qualified plan or section 403(b) annuity. An exception to this rule applies in the case of so-called "conduit IRAs." Under the conduit IRA rule, amounts can be rolled from a qualified plan into an IRA and then subsequently rolled back to another qualified plan if the amounts in the IRA are attributable solely to rollovers from a qualified plan. Similarly, an amount may be rolled over from a section 403(b) annuity to an IRA and subsequently rolled back into a section 403(b) annuity if the amounts in the IRA are attributable solely to rollovers from a section 403(b) annuity.

Distributions from section 457 plans

A "section 457 plan" is an eligible deferred compensation plan of a State or local government or tax-exempt employer that meets certain requirements. In some cases, different rules apply under section 457 to governmental plans and plans of tax-exempt employers. For example, governmental section 457 plans are like qualified plans in that plan assets are required to be held in a trust for the exclusive benefit of plan participants and beneficiaries. In contrast, benefits under a section 457 plan of a tax-exempt employer are unfunded, like nonqualified deferred compensation plans of private employers.

Section 457 benefits can be transferred to another section 457 plan. Distributions from a section 457 plan cannot be rolled over to another section 457 plan, a qualified plan, a section 403(b) annuity, or an IRA.

Rollovers by surviving spouses

A surviving spouse that receives an eligible rollover distribution may roll over the distribution into an IRA, but not a qualified plan or section 403(b) annuity.

Direct rollovers and withholding requirements

Qualified plans and section 403(b) annuities are required to provide that a plan participant has the right to elect that an eligible rollover distribution be directly rolled over to another eligible retirement plan. If the plan participant does not elect the direct rollover option, then withholding is required on the distribution at a 20-percent rate.

Notice of eligible rollover distribution

The plan administrator of a qualified plan or a section 403(b) annuity is required to provide a written explanation of rollover rules to individuals who receive a distribution eligible for rollover. In general, the notice is to be provided within a reasonable period of time before making the distribution and is to include an explanation of (1) the provisions under which the individual may have the distribution directly rolled over to another eligible retirement plan, (2) the provision that requires withholding if the distribution is not directly rolled over, (3) the provision under which the distribution may be rolled over within 60 days of receipt, and (4) if applicable, certain other rules that may apply to the distribution. The Treasury Department has provided more specific guidance regarding timing and content of the notice.

Taxation of distributions

As is the case with the rollover rules, different rules regarding taxation of benefits apply to different types of tax-favored arrangements. In general, distributions from a qualified plan, section 403(b) annuity, or IRA are includible in income in the year received. In certain cases, distributions from qualified plans are eligible for capital gains treatment and averaging. These rules do not apply to distributions from another type of plan. Distributions from a qualified plan, IRA, and section 403(b) annuity generally are subject to an additional 10-percent early withdrawal tax if made before age 59-1/2. There are a number of exceptions to the early withdrawal tax. Some of the exceptions apply to all three types of plans, and others apply only to certain types of plans. For example, the 10-percent early withdrawal tax does not apply to IRA distributions for educational expenses, but does apply to similar distributions from qualified plans and section 403(b) annuities. Benefits under a section 457 plan are generally includible in income when paid or made available. The 10-percent early withdrawal tax does not apply to section 457 plans.

Description of Proposal

In general

The proposal would provide that eligible rollover distributions from qualified retirement plans, section 403(b) annuities, and governmental section 457 plans generally could be rolled over to any of such plans or arrangements.[30] Similarly, distributions from an IRA generally would be permitted to be rolled over into a qualified plan, section 403(b) annuity, or governmental section 457 plan. The direct rollover and withholding rules would be extended to distributions from a governmental section 457 plan, and such plans would be required to provide the written notification regarding eligible rollover distributions. The rollover notice (with respect to all plans) would be required to include a description of the provisions under which distributions from the plan to which the distribution is rolled over may be subject to restrictions and tax consequences different than those applicable to distributions from the distributing plan.

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[30] Hardship distributions from governmental section 457 plans would be considered eligible rollover distributions.

Qualified plans, section 403(b) annuities, and section 457 plans would not be required to accept rollovers.

Some special rules would apply in certain cases. A distribution from a qualified plan would not be eligible for capital gains or averaging treatment if there was a rollover to the plan that would not have been permitted under present law. Thus, in order to preserve capital gains and averaging treatment for a qualified plan distribution that is rolled over, the rollover would have to be made to a "conduit IRA" as under present law, and then rolled back into a qualified plan. Amounts distributed from a section 457 plan would be subject to the early withdrawal tax to the extent the distribution consists of amounts attributable to rollovers from another type of plan. Section 457 plans would be required to separately account for such amounts.

Rollover of after-tax contributions

The proposal would provide that employee after-tax contributions may be rolled over into another qualified plan or a traditional IRA. In the case of a rollover from a qualified plan to another qualified plan, the rollover would be permitted to be accomplished only through a direct rollover. In addition, a qualified plan would not be permitted to accept rollovers of after-tax contributions unless the plan provides separate accounting for such contributions (and earnings thereon). After-tax contributions (including nondeductible contributions to an IRA) would not be permitted to be rolled over from an IRA into a qualified plan, tax-sheltered annuity, or section 457 plan.

In the case of a distribution from a traditional IRA that is rolled over into an eligible rollover plan that is not an IRA, the distribution would be attributed first to amounts other than after-tax contributions.

Expansion of spousal rollovers

The proposal would provide that surviving spouses may roll over distributions to a qualified plan, section 403(b) annuity, or governmental section 457 plan in which the spouse participates.

Treasury regulations

The Secretary would be directed to prescribe rules necessary to carry out the proposals. Such rules may include, for example, reporting requirements and mechanisms to address mistakes relating to rollovers. It would be anticipated that the IRS would develop forms to assist individuals who roll over after-tax contributions to an IRA in keeping track of such contributions. Such forms could, for example, expand Form 8606 - Nondeductible IRAs, to include information regarding after-tax contributions.

Effective Date

The proposal would be effective for distributions made after December 31, 2001. It would be intended that the Secretary would revise the safe harbor rollover notice that plans may use to satisfy the rollover requirements. No penalty would be imposed on a plan for a failure to provide the information required under the proposal with respect to any distribution made before the date that is 90 days after the date the Secretary issues a new safe harbor rollover notice, if the plan administrator makes a reasonable attempt to comply with such notice requirement. For example, the proposal would require that the rollover notice include a description of the provisions under which distributions from the eligible retirement plan receiving the distribution may be subject to restrictions and tax consequences which are different from those applicable to distributions from the plan making the distribution. A plan would be treated as making a reasonable good faith effort to comply with this requirement if the notice states that distributions from the plan to which the rollover is made may be subject to different restrictions and tax consequences than those that apply to distributions from the plan from which the rollover is made.

2. Waiver of 60-day rule

Present Law

Under present law, amounts received from an IRA or qualified plan may be rolled over tax free if the rollover is made within 60 days of the date of the distribution. The Secretary does not have the authority to waive the 60-day requirement.

Description of Proposal

The proposal would provide that the Secretary may waive the 60-day rollover period if the failure to waive such requirement would be against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement.

Effective Date

The proposal would apply to distributions made after December 31, 2001.

3. Treatment of forms of distribution

Present Law

An amendment of a qualified retirement plan may not decrease the accrued benefit of a plan participant. An amendment is treated as reducing an accrued benefit if, with respect to benefits accrued before the amendment is adopted, the amendment has the effect of either (1) eliminating or reducing an early retirement benefit or a retirement-type subsidy, or (2) except as provided by Treasury regulations, eliminating an optional form of benefit (sec. 411(d)(6)).[31]

The prohibition against the elimination of an optional form of benefit applies to plan mergers, spinoffs, transfers, and transactions amending or having the effect of amending a plan or plans to transfer plan benefits. For example, if Plan A, a profit-sharing plan that provides for distribution of benefits in annual installments over ten or twenty years, is merged with Plan B, a

[31] A similar provision is contained in Title I of ERISA.

profit-sharing plan that provides for distribution of benefits in annual installments over life expectancy at the time of retirement, the merged plan must preserve the ten- or twenty-year installment option with respect to benefits accrued under Plan A as of the date of the merger and the installments over life expectancy with respect to benefits accrued under Plan B as of the date of the merger. Similarly, for example, if a participant's benefit under a defined contribution plan is transferred to another defined contribution plan maintained by the same or a different employer, the optional forms of benefit available with respect to the participant's accrued benefit under the transferor plan must be preserved.[32]

Description of Proposal

A defined contribution plan to which benefits are transferred would not be treated as reducing a participant's or beneficiary's accrued benefit even though it does not provide all of the forms of distribution previously available under the transferor plan if (1) the plan receives from another defined contribution plan a direct transfer of the participant's or beneficiary's benefit accrued under the transferor plan, or the plan results from a merger or other transaction that has the effect of a direct transfer (including consolidations of benefits attributable to different employers within a multiple employer plan), (2) the terms of both the transferor plan and the transferee plan authorize the transfer, (3) the transfer occurs pursuant to a voluntary election by the participant or beneficiary that is made after the participant or beneficiary received a notice describing the consequences of making the election, (4) if the transferor plan provides for an annuity as the normal form of distribution in accordance with the joint and survivor annuity rules (sec. 417), the participant's spouse (if any) consents to the transfer in a manner similar to the consent required by section 417, and (5) the transferee plan allows the participant or beneficiary to receive distribution of his or her benefit under the transferee plan in the form of a single sum distribution.

Except to the extent provided by the Secretary of the Treasury in regulations, a defined contribution plan would not be treated as reducing a participant's accrued benefit if (1) a plan amendment eliminates a form of distribution previously available under the plan, (2) a single sum distribution is available to the participant at the same time or times as the form of distribution eliminated by the amendment, and (3) the single sum distribution is based on the same or greater portion of the participant's accrued benefit as the form of distribution eliminated by the amendment.

Furthermore, the proposal would direct the Secretary of the Treasury to provide by regulations that the prohibitions against eliminating or reducing an early retirement benefit, a retirement-type subsidy, or an optional form of benefit do not apply to plan amendments that eliminate or reduce early retirement benefits, retirement-type subsidies, and optional forms of benefit that create significant burdens and complexities for a plan and its participants, but only if such an amendment does not adversely affect the rights of any participant in more than a de minimis manner.

[32] Treas. Reg. sec. 1.411(d)-4, Q&A-2(a)(3)(i).

It would be intended that the factors to be considered in determining whether an amendment has more than a de minimis adverse effect on any participant would include (1) all of the participant's early retirement benefits, retirement-type subsidies, and optional forms of benefits that are reduced or eliminated by the amendment, (2) the extent to which early retirement benefits, retirement-type subsidies, and optional forms of benefit in effect with respect to a participant after the amendment effective date provide rights that are comparable to the rights that are reduced or eliminated by the plan amendment, (3) the number of years before the participant attains normal retirement age under the plan (or early retirement age, as applicable), (4) the size of the participant's benefit that is affected by the plan amendment, in relation to the amount of the participant's compensation, and (5) the number of years before the plan amendment is effective.

This provision of the proposal would not affect the rules relating to involuntary cash outs (sec. 411(a)(11))[33] or survivor annuity requirements (sec. 417).

The Secretary would be directed to issue, not later than December 31, 2003, final regulations under section 411(d)(6), including regulations required under the proposal.

Effective Date

The proposal would be effective for years beginning after December 31, 2001, except that the direction to the Secretary would be effective on the date of enactment.

4. Rationalization of restrictions on distributions

Present Law

Elective deferrals under a qualified cash or deferred arrangement ("section 401(k) plan"), tax-sheltered annuity ("section 403(b) annuity"), or an eligible deferred compensation plan of a tax-exempt organization or State or local government ("section 457 plan"), may not be distributable prior to the occurrence of one or more specified events. These permissible distributable events include "separation from service."

A separation from service occurs only upon a participant's death, retirement, resignation or discharge, and not when the employee continues on the same job for a different employer as a result of the liquidation, merger, consolidation or other similar corporate transaction. A severance from employment occurs when a participant ceases to be employed by the employer that maintains the plan. Under a so-called "same desk rule," a participant's severance from employment does not necessarily result in a separation from service.[34]

In addition to separation from service and other events, a section 401(k) plan that is maintained by a corporation may permit distributions to certain employees who experience a severance from employment with the corporation that maintains the plan but does not experience

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[33] Another provision of the proposal would provide that rollover amounts are not taken into account for purposes of the cash-out rules.

[34] Rev. Rul. 79-336, 1979-2 C.B. 187.

a separation from service because the employee continues on the same job for a different employer as a result of a corporate transaction. If the corporation disposes of substantially all of the assets used by the corporation in a trade or business, a distributable event occurs with respect to the accounts of the employees who continue employment with the corporation that acquires the assets. If the corporation disposes of its interest in a subsidiary, a distributable event occurs with respect to the accounts of the employees who continue employment with the subsidiary.

Description of Proposal

The proposal would modify the distribution restrictions applicable to section 401(k) plans, section 403(b) annuities, and section 457 plans to provide that distribution may occur upon severance from employment rather than separation from service. In addition, the provisions for distribution from a section 401(k) plan based upon a corporation's disposition of its assets or a subsidiary would be repealed; this special rule would no longer be necessary under the proposal.

Effective Date

The proposal would be effective for distributions after December 31, 2001, regardless of when the severance of employment occurred.

5. Purchase of service credit under governmental pension plans

Present Law

A qualified retirement plan maintained by a State or local government employer may provide that a participant may make after-tax employee contributions in order to purchase permissive service credit, subject to certain limits (sec. 415). Permissive service credit means credit for a period of service recognized by the governmental plan only if the employee voluntarily contributes to the plan an amount (as determined by the plan) that does not exceed the amount necessary to fund the benefit attributable to the period of service and that is in addition to the regular employee contributions, if any, under the plan.

In the case of any repayment of contributions and earnings to a governmental plan with respect to an amount previously refunded upon a forfeiture of service credit under the plan (or another plan maintained by a State or local government employer within the same State), any such repayment is not taken into account for purposes of the section 415 limits on contributions and benefits. Also, service credit obtained as a result of such a repayment is not considered permissive service credit for purposes of the section 415 limits.

A participant may not use a rollover or direct transfer of benefits from a tax-sheltered annuity ("section 403(b) annuity") or an eligible deferred compensation plan of a tax-exempt organization of a State or local government ("section 457 plan") to purchase permissive service credits or repay contributions and earnings with respect to a forfeiture of service credit.

Description of Proposal

A participant in a State or local governmental plan would not be required to include in gross income a direct trustee-to-trustee transfer to a governmental defined benefit plan from a section 403(b) annuity or a section 457 plan if the transferred amount is used (1) to purchase permissive service credits under the plan, or (2) to repay contributions and earnings with respect to an amount previously refunded under a forfeiture of service credit under the plan (or another plan maintained by a State or local government employer within the same State).

Effective Date

The proposal would be effective for transfers after December 31, 2001.

6. Employers may disregard rollovers for purposes of cash-out rules

Present Law

If an qualified retirement plan participant ceases to be employed by the employer that maintains the plan, the plan may distribute the participant's nonforfeitable accrued benefit without the consent of the participant and, if applicable, the participant's spouse, if the present value of the benefit does not exceed $5,000. If such an involuntary distribution occurs and the participant subsequently returns to employment covered by the plan, then service taken into account in computing benefits payable under the plan after the return need not include service with respect to which a benefit was involuntarily distributed unless the employee repays the benefit.[35]

Generally, a participant may roll over an involuntary distribution from a qualified plan to an IRA or to another qualified plan.[36]

Description of Proposal

A plan would be permitted to provide that the present value of a participant's nonforfeitable accrued benefit is determined without regard to the portion of such benefit that is attributable to rollover contributions (and any earnings allocable thereto).

Effective Date

The proposal would be effective for distributions after December 31, 2001.

[35] A similar provision is contained in Title I of ERISA.

[36] Other proposals expand the kinds of plans to which benefits may be rolled over.

7. Minimum distribution and inclusion requirements for section 457 plans

Present Law

A "section 457 plan" is an eligible deferred compensation plan of a State or local government or tax-exempt employer that meets certain requirements. For example, amounts deferred under a section 457 plan cannot exceed certain limits. Amounts deferred under a section 457 plan are generally includible in income when paid or made available. Amounts deferred under a plan of deferred compensation of a State or local government or tax-exempt employer that does not meet the requirements of section 457 are includible in income when the amounts are not subject to a substantial risk of forfeiture, regardless of whether the amounts have been paid or made available.[37]

Section 457 plans are subject to the minimum distribution rules applicable to tax-qualified pension plans. In addition, such plans are subject to additional minimum distribution rules (sec. 457(d)(2)(B)).

Description of Proposal

The proposal would provide that amounts deferred under a section 457 plan of a State or local government are includible in income when paid. The proposal also would repeal the special minimum distribution rules applicable to section 457 plans. Thus, such plans would be subject to the minimum distribution rules applicable to qualified plans.

Effective Date

The proposal would be effective for distributions after December 31, 2001.

D. Strengthening Pension Security and Enforcement

1. Phase in repeal of 160 percent of current liability funding limit; deduction for contributions to fund termination liability

Present Law

Under present law, defined benefit pension plans are subject to minimum funding requirements designed to ensure that pension plans have sufficient assets to pay benefits. A defined benefit pension plan is funded using one of a number of acceptable actuarial cost methods.

No contribution is required under the minimum funding rules in excess of the full funding limit. The full funding limit is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) 160 percent of the plan's current

[37] This rule of inclusion does not apply to amounts deferred under a tax-qualified retirement plan or similar plans.

liability, over (2) the value of the plan's assets (sec. 412(c)(7)).[38] In general, current liability is all liabilities to plan participants and beneficiaries accrued to date, whereas the accrued liability full funding limit is based on projected benefits. The current liability full funding limit is scheduled to increase as follows: 165 percent for plan years beginning in 2003 and 2004, and 170 percent for plan years beginning in 2005 and thereafter.[39] In no event is a plan's full funding limit less than 90 percent of the plan's current liability over the value of the plan's assets.

An employer sponsoring a defined benefit pension plan generally may deduct amounts contributed to satisfy the minimum funding standard for the plan year. Contributions in excess of the full funding limit generally are not deductible. Under a special rule, an employer that sponsors a defined benefit pension plan (other than a multiemployer plan) which has more than 100 participants for the plan year may deduct amounts contributed of up to 100 percent of the plan's unfunded current liability.

Description of Proposal

Current liability full funding limit

The proposal would gradually increase and then repeal the current liability full funding limit. The current liability full funding limit would be 165 percent of current liability for plan years beginning in 2002, and 170 percent for plan years beginning in 2003. The current liability full funding limit would be repealed for plan years beginning in 2004 and thereafter. Thus, in 2004 and thereafter, the full funding limit would be the excess, if any, of (1) the accrued liability under the plan (including normal cost), over (2) the value of the plan's assets.

Deduction for contributions to fund termination liability

The special rule allowing a deduction for unfunded current liability generally would be extended to all defined benefit pension plans, i.e., the proposal would apply to multiemployer plans and plans with 100 or fewer participants. The special rule would not apply to plans not covered by the PBGC termination insurance program.[40]

The proposal also would modify the rule by providing that the deduction is for up to 100 percent of unfunded termination liability, determined as if the plan terminated at the end of the plan year. In the case of a plan with less than 100 participants for the plan year, termination liability would not include the liability attributable to benefit increases for highly compensated

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[38] The minimum funding requirements, including the full funding limit, are also contained in title I of ERISA.

[39] As originally enacted in the Pension Protection Act of 1997, the current liability full funding limit was 150 percent of current liability. The Taxpayer Relief Act of 1997 increased the current liability full funding limit to 155 percent in 1999 and 2000, 160 percent in 2001 and 2002, and adopted the scheduled increases described in the text.

[40] The PBGC termination insurance program does not cover plans of professional service employers that have fewer than 25 participants.

employees resulting from a plan amendment which was made or became effective, whichever is later, within the last two years.

Effective Date

The proposal would be effective for plan years beginning after December 31, 2001.

2. Excise tax relief for sound pension funding

Present Law

Under present law, defined benefit pension plans are subject to minimum funding requirements designed to ensure that pension plans have sufficient assets to pay benefits. A defined benefit pension plan is funded using one of a number of acceptable actuarial cost methods.

No contribution is required under the minimum funding rules in excess of the full funding limit. The full funding limit is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) 160 percent of the plan's current liability, over (2) the value of the plan's assets (sec. 412(c)(7)). In general, current liability is all liabilities to plan participants and beneficiaries accrued to date, whereas the accrued liability full funding limit is based on projected benefits. The current liability full funding limit is scheduled to increase as follows: 165 percent for plan years beginning in 2003 and 2004, and 170 percent for plan years beginning in 2005 and thereafter.[41] In no event is a plan's full funding limit less than 90 percent of the plan's current liability over the value of the plan's assets.

An employer sponsoring a defined benefit pension plan generally may deduct amounts contributed to satisfy the minimum funding standard for the plan year. Contributions in excess of the full funding limit generally are not deductible. Under a special rule, an employer that sponsors a defined benefit pension plan (other than a multiemployer plan) which has more than 100 participants for the plan year may deduct amounts contributed of up to 100 percent of the plan's unfunded current liability.

Present law also provides that contributions to defined contribution plans are deductible, subject to certain limitations.

Subject to certain exceptions, an employer that makes nondeductible contributions to a plan is subject to an excise tax equal to 10 percent of the amount of the nondeductible contributions for the year. The 10-percent excise tax does not apply to contributions to certain terminating defined benefit plans. The 10-percent excise tax also does not apply to contributions

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[41] As originally enacted in the Pension Protection Act of 1997, the current liability full funding limit was 150 percent of current liability. The Taxpayer Relief Act of 1997 increased the current liability full funding limit to 155 percent in 1999 and 2000, 160 percent in 2001 and 2002, and adopted the scheduled increases described in the text. Another proposal would gradually increase and then repeal the current liability full funding limit.

of up to 6 percent of compensation to a defined contribution plan for employer matching and employee elective deferrals.

Description of Proposal

In determining the amount of nondeductible contributions, the employer would be permitted to elect not to take into account contributions to a defined benefit pension plan except to the extent they exceed the accrued liability full funding limit. Thus, if an employer elects, contributions in excess of the current liability full funding limit would not be subject to the excise tax on nondeductible contributions. An employer making such an election for a year would not be permitted to take advantage of the present-law exceptions for certain terminating plans and certain contributions to defined contribution plans.

Effective Date

The proposal would be effective for years beginning after December 31, 2001.

3. Notice of significant reduction in plan benefit accruals

Present Law

Section 204(h) of Title I of ERISA provides that a defined benefit pension plan or a money purchase pension plan may not be amended so as to provide for a significant reduction in the rate of future benefit accrual, unless, after adoption of the plan amendment and not less than 15 days before the effective date of the plan amendment, the plan administrator provides a written notice ("section 204(h) notice"), setting forth the plan amendment (or a summary of the amendment written in a manner calculated to be understood by the average plan participant) and its effective date. The plan administrator must provide the section 204(h) notice to each plan participant, each alternate payee under an applicable qualified domestic relations order ("QDRO"), and each employee organization representing participants in the plan. The applicable Treasury regulations[42] provide, however, that a plan administrator need not provide the section 204(h) notice to any participant or alternate payee whose rate of future benefit accrual is reasonably expected not to be reduced by the amendment, nor to an employee organization that does not represent a participant to whom the section 204(h) notice must be provided. In addition, the regulations provide that the rate of future benefit accrual is determined without regard to optional forms of benefit, early retirement benefits, retirement-type subsidiaries, ancillary benefits, and certain other rights and features.

A covered amendment generally will not become effective with respect to any participants and alternate payees whose rate of future benefit accrual is reasonably expected to be reduced by the amendment but who do not receive a section 204(h) notice. An amendment will become effective with respect to all participants and alternate payees to whom the section 204(h) notice was required to be provided if the plan administrator (1) has made a good faith effort to comply with the section 204(h) notice requirements, (2) has provided a section 204(h) notice to each employee organization that represents any participant to whom a section 204(h) notice was

[42] Treas. Reg. sec. 1.411(d)-6.

required to be provided, (3) has failed to provide a section 204(h) notice to no more than a de minimis percentage of participants and alternate payees to whom a section 204(h) notice was required to be provided, and (4) promptly upon discovering the oversight, provides a section 204(h) notice to each omitted participant and alternate payee.

The Internal Revenue Code does not require any notice concerning a plan amendment that provides for a significant reduction in the rate of future benefit accrual.

Description of Proposal

The proposal would add to the Internal Revenue Code a requirement that the plan administrator of a defined benefit pension plan or a money purchase pension plan furnish a written notice concerning a plan amendment that provides for a significant reduction in the rate of future benefit accrual, including any elimination or reduction of an early retirement benefit or retirement-type subsidy. The plan administrator would be required to provide in this notice, in a manner calculated to be understood by the average plan participant, sufficient information (as defined in Treasury regulations) to allow participants to understand the effect of the amendment.

The notice requirement would not apply to governmental plans or church plans with respect to which an election to have the qualified plan participation, vesting, and funding rules apply has not been made (sec. 410(d)). The proposal would authorize the Secretary of the Treasury to provide a simplified notice requirement or an exemption from the notice requirement for plans with less than 100 participants and to allow any notice required under the proposal to be provided by using new technologies. The proposal also would authorize the Secretary to provide a simplified notice requirement or an exemption from the notice requirement if participants are given the option to choose between benefits under the new plan formula and the old plan formula. In such cases, the proposal would have no effect on the fiduciary rules applicable to pension plans that may require appropriate disclosure to participants, even if no disclosure is required under the proposal.

The plan administrator would be required to provide this notice to each affected participant, each affected alternate payee, and each employee organization representing affected participants. For purposes of the proposal, an affected participant or alternate payee would be a participant or alternate payee whose rate of future benefit accrual may reasonably be expected to be significantly reduced by the plan amendment.

Except to the extent provided by Treasury regulations, the plan administrator would be required to provide the notice within a reasonable time before the effective date of the plan amendment. The proposal would permit a plan administrator to provide any notice required under the provision to a person designated in writing by the individual to whom it would otherwise be provided.

The proposal would impose on a plan administrator that fails to comply with the notice requirement an excise tax equal to $100 per day per omitted participant and alternate payee. No excise tax would be imposed during any period during which any person subject to liability for the tax did not know that the failure existed and exercised reasonable diligence to meet the notice requirement. In addition, no excise tax would be imposed on any failure if any person subject to liability for the tax exercised reasonable diligence to meet the notice requirement and such person provides the required notice during the 30-day period beginning on the first date such person knew, or exercising reasonable diligence would have known, that the failure existed. Also, if the person subject to liability for the excise tax exercised reasonable diligence to meet the notice requirement, the total excise tax imposed during a taxable year of the employer would not exceed $500,000. Furthermore, in the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury would be authorized to waive the excise tax to the extent that the payment of the tax would be excessive relative to the failure involved.

It would be intended under the proposal that the Secretary issue the necessary regulations with respect to disclosure within 90 days of enactment. It would also be intended that such guidance may be relatively detailed because of the need to provide for alternative disclosures rather than a single disclosure methodology that may not fit all situations, and the need to consider the complex actuarial calculations and assumptions involved in providing necessary disclosures.

In addition, the proposal would direct the Secretary of the Treasury to prepare a report on the effects of conversions of traditional defined benefit plans to cash balance or hybrid formula plans. Such study would examine the effect of such conversions on longer service participants, including the incidence and effects of "wear away" provisions under which participants earn no additional benefits for a period of time after the conversion. The Secretary would be directed to submit such report, together with recommendations thereon, to the Committee on Ways and Means and the Committee on Education and the Workforce of the House of Representatives and the Committee on Finance and the Committee on Health, Education, Labor, and Pensions of the Senate as soon as practicable, but not later than 60 days after the date of enactment.

Effective Date

The proposal would be effective for plan amendments taking effect on or after the date of enactment. The period for providing any notice required under the proposal would not end before the last day of the 3-month period following the date of enactment. Prior to the issuance of Treasury regulations, a plan would be treated as meeting the requirements of the proposal if the plan makes a good faith effort to comply with such requirements. The notice requirement under the proposal would not apply to any plan amendment taking effect on or after the date of enactment if, before April 25, 2001, notice is provided to participants and beneficiaries adversely affected by the plan amendment (or their representatives) that is reasonably expected to notify them of the nature and effective date of the plan amendment.

4. Modifications to section 415 limits for multiemployer plans

Present Law

Under present law, limits apply to contributions and benefits under qualified plans (sec. 415). The limits on contributions and benefits under qualified plans are based on the type of plan.

Under a defined benefit plan, the maximum annual benefit payable at retirement is generally the lesser of (1) 100 percent of average compensation for the highest three years, or (2) $140,000 (for 2001). The dollar limit is adjusted for cost-of-living increases in $5,000 increments. The dollar limit is reduced in the case of retirement before the social security retirement age and increases in the case of retirement after the social security retirement age.

A special rule applies to governmental defined benefit plans. In the case of such plans, the defined benefit dollar limit is reduced in the case of retirement before age 62 and increased in the case of retirement after age 65. In addition, there is a floor on early retirement benefits. Pursuant to this floor, the minimum benefit payable at age 55 is $75,000.

In the case of a defined contribution plan, the limit on annual is additions if the lesser of (1) 25 percent of compensation[43] or (2) $35,000 (for 2001).

In applying the limits on contributions and benefits, plans of the same employer are aggregated. That is, all defined benefit plans of the same employer are treated as a single plan, and all defined contribution plans of the same employer are treated as a single plan. Under Treasury regulations, multiemployer plans are not aggregated with other multiemployer plans. However, if an employer maintains both a plan that is not a multiemployer plan and a mulitemployer plan, the plan that is not a multiemployer plan is aggregated with the multiemployer plan to the extent that benefits provided under the multiemployer plan are provided with respect to a common participant.[44]

Description of Proposal

Under the proposal, the 100 percent of compensation defined benefit plan limit would not apply to multiemployer plans. With respect to aggregation of multiemployer plans with other plans, the proposal would provide that multiemployer plans are not aggregated with single-employer defined benefit plans maintained by an employer contributing to the multiemployer plan for purposes of applying the 100 percent of compensation limit to such single-employer plan.

Effective Date

The proposal would be effective for years beginning after December 31, 2001.

5. Prohibited allocations of stock in an S corporation ESOP

Present Law

The Small Business Job Protection Act of 1996 allowed qualified retirement plan trusts described in section 401(a) to own stock in an S corporation. That Act treated the plan's share of the S corporation's income (and gain on the disposition of the stock) as includible in full in the trust's unrelated business taxable income ("UBTI").

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[43] Another proposal would increase this limit to 100 percent of compensation.
[44] Treas. Reg. sec. 1.415-8(e).

The Tax Relief Act of 1997 repealed the provision treating items of income or loss of an S corporation as UBTI in the case of an employee stock ownership plan ("ESOP"). Thus, the income of an S corporation allocable to an ESOP is not subject to current taxation.

Present law provides a deferral of income on the sales of certain employer securities to an ESOP (sec. 1042). A 50-percent excise tax is imposed on certain prohibited allocations of securities acquired by an ESOP in a transaction to which section 1042 applies. In addition, such allocations are currently includible in the gross income of the individual receiving the prohibited allocation.

Description of Proposal

In general

Under the proposal, if there is a nonallocation year with respect to an ESOP maintained by an S corporation: (1) the amount allocated in a prohibited allocation to an individual who is a disqualified person would be treated as distributed to such individual (i.e., the value of the prohibited allocation is includible in the gross income of the individual receiving the prohibited allocation); (2) an excise tax would be imposed on the S corporation equal to 50 percent of the amount involved in a prohibited allocation; and (3) an excise tax would be imposed on the S corporation with respect to any synthetic equity owned by a disqualified person.[45]

It is intended that the proposal will limit the establishment of ESOPs by S corporations to those that provide broad-based employee coverage and that benefit rank-and-file employees as well as highly compensated employees and historical owners.

Definition of nonallocation year

A nonallocation year would mean any plan year of an ESOP holding shares in an S corporation if, at any time during the plan year, disqualified persons own at least 50 percent of the number of outstanding shares of the S corporation.

A person would be a disqualified person if the person is either (1) a member of a "deemed 20-percent shareholder group" or (2) a "deemed 10-percent shareholder." A person would be a member of a "deemed 20-percent shareholder group" if the aggregate number of deemed-owned shares of the person and his or her family members is at least 20 percent of the number of deemed-owned shares of stock in the S corporation.[46] A person would be a deemed 10-percent shareholder if the person is not a member of a deemed 20-percent shareholder group and the number of the person's deemed-owned shares is at least 10 percent of the number of deemed-owned shares of stock of the corporation.

[45] The plan would not be disqualified merely because an excise tax is imposed under the provision.

[46] A family member of a member of a "deemed 20-percent shareholder group" with deemed owned shares would also be treated as a disqualified person.

In general, "deemed-owned shares" would mean: (1) stock allocated to the account of an individual under the ESOP, and (2) an individual's share of unallocated stock held by the ESOP. An individual's share of unallocated stock held by an ESOP would be determined in the same manner as the most recent allocation of stock under the terms of the plan.

For purposes of determining whether there is a nonallocation year, ownership of stock generally would be attributed under the rules of section 318,[47] except that: (1) the family attribution rules would be modified to include certain other family members, as described below, (2) option attribution would not apply (but instead special rules relating to synthetic equity described below would apply), and (3) "deemed-owned shares" held by the ESOP would be treated as held by the individual with respect to whom they are deemed owned.

Under the proposal, family members of an individual would include (1) the spouse[48] of the individual, (2) an ancestor or lineal descendant of the individual or his or her spouse, (3) a sibling of the individual (or the individual's spouse) and any lineal descendant of the brother or sister, and (4) the spouse of any person described in (2) or (3).

The proposal contains special rules applicable to synthetic equity interests. Except to the extent provided in regulations, the stock on which a synthetic equity interest is based would be treated as outstanding stock of the S corporation and as deemed-owned shares of the person holding the synthetic equity interest if such treatment would result in the treatment of any person as a disqualified person or the treatment of any year as a nonallocation year. Thus, for example, disqualified persons for a year would include those individuals who are disqualified persons under the general rule (i.e., treating only those shares held by the ESOP as deemed-owned shares) and those individuals who are disqualified individuals if synthetic equity interests are treated as deemed-owned shares.

"Synthetic equity" would mean any stock option, warrant, restricted stock, deferred issuance stock right, or similar interest that gives the holder the right to acquire or receive stock of the S corporation in the future. Except to the extent provided in regulations, synthetic equity also would include a stock appreciation right, phantom stock unit, or similar right to a future cash payment based on the value of such stock or appreciation in such value.[49]

Ownership of synthetic equity would be attributed in the same manner as stock would be attributed under the proposal (as described above). In addition, ownership of synthetic equity would be attributed under the rules of section 318(a)(2) and (3) in the same manner as stock.

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[47] These attribution rules also apply to stock treated as owned by reason of the ownership of synthetic equity.

[48] As under section 318, an individual's spouse is not treated as a member of the individual's family if the spouses are legally separated.

[49] The provisions relating to synthetic equity would not modify the rules relating to S corporations, e.g., the circumstances in which options or similar interests are treated as creating a second class of stock.

Definition of prohibited allocation

An ESOP of an S corporation would be required to provide that no portion of the assets of the plan attributable to (or allocable in lieu of) S corporation stock may, during a nonallocation year, accrue (or be allocated directly or indirectly under any qualified plan of the S corporation) for the benefit of a disqualified person. A "prohibited allocation" would refer to violations of this provision. A prohibited allocation would occur, for example, if income on S corporation stock held by an ESOP is allocated to the account of an individual who is a disqualified person.

Application of excise tax

In the case of a prohibited allocation, the S corporation would be liable for an excise tax equal to 50 percent of the amount of the allocation. For example, if S corporation stock is allocated in a prohibited allocation, the excise tax would equal to 50 percent of the fair market value of such stock.

A special rule would apply in the case of the first nonallocation year, regardless of whether there is a prohibited allocation. In that year, the excise tax also would apply to the fair market value of the deemed-owned shares of any disqualified person held by the ESOP, even though those shares are not allocated to the disqualified person in that year.

As mentioned above, the S corporation also would be liable for an excise tax with respect to any synthetic equity interest owned by any disqualified person in a nonallocation year. The excise tax would be 50 percent of the value of the shares on which synthetic equity is based.

Treasury regulations

The Treasury Department would be given the authority to prescribe such regulations as may be necessary to carry out the purposes of the proposal.

Effective Date

The proposal generally would be effective with respect to plan years beginning after December 31, 2004. In the case of an ESOP established after March 14, 2001, or an ESOP established on or before such date if the employer maintaining the plan was not an S corporation on such date, the proposal would be effective with respect to plan years ending after March 14, 2001.

E. Reducing Regulatory Burdens

1. Modification of timing of plan valuations

Present Law

Under present law, plan valuations are generally required annually for plans subject to the minimum funding rules. Under proposed Treasury regulations, except as provided by the

Commissioner, the valuation must be as of a date within the plan year to which the valuation refers or within the month prior to the beginning of that year.[50]

Description of Proposal

The proposal would incorporate into the statute the proposed regulation regarding the date of valuations. The proposal would also provide, as an exception to this general rule, that the valuation date with respect to a plan year may be any date within the immediately preceding plan year if, as of such date, plan assets are not less than 125 percent of the plan's current liability. Information determined as of such date would be required to be adjusted actuarially, in accordance with Treasury regulations, to reflect significant differences in plan participants. An election to use a prior plan year valuation date, once made, could only be revoked with the consent of the Secretary.

Effective Date

The proposal would be effective for plan years beginning after December 31, 2001.

2. ESOP dividends may be reinvested without loss of dividend deduction

Present Law

An employer is entitled to deduct certain dividends paid in cash during the employer's taxable year with respect to stock of the employer that is held by an employee stock ownership plan ("ESOP"). The deduction is allowed with respect to dividends that, in accordance with plan provisions, are (1) paid in cash directly to the plan participants or their beneficiaries, (2) paid to the plan and subsequently distributed to the participants or beneficiaries in cash no later than 90 days after the close of the plan year in which the dividends are paid to the plan, or (3) used to make payments on loans (including payments of interest as well as principal) that were used to acquire the employer securities (whether or not allocated to participants) with respect to which the dividend is paid.

The Secretary may disallow the deduction for any ESOP dividend if he determines that the dividend constitutes, in substance, an evasion of taxation (sec. 404(k)(5)).

Description of Proposal

In addition to the deductions permitted under present law for dividends paid with respect to employer securities that are held by an ESOP, an employer would be entitled to deduct dividends that, at the election of plan participants or their beneficiaries, are (1) payable in cash directly to plan participants or beneficiaries, (2) paid to the plan and subsequently distributed to the participants or beneficiaries in cash no later than 90 days after the close of the plan year in which the dividends are paid to the plan, or (3) paid to the plan and reinvested in qualifying employer securities.

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[50] Prop. Treas. Reg. sec. 1.412(c)(9)-1(b)(1).

The proposal would permit the Secretary to disallow the deduction for any ESOP dividend if he determines that the dividend constitutes, in substance, the avoidance or evasion of taxation.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 2001.

3. Repeal transition rule relating to certain highly compensated employees

Present Law

Under present law, for purposes of the rules relating to qualified plans, a highly compensated employee is generally defined as an employee[51] who (1) was a 5-percent owner of the employer at any time during the year or the preceding year or (2) either (a) had compensation for the preceding year in excess of $85,000 (for 2001) or (b) at the election of the employer, had compensation in excess of $85,000 for the preceding year and was in the top 20 percent of employees by compensation for such year.

Under a rule enacted in the Tax Reform Act of 1986, a special definition of highly compensated employee applies for purposes of the nondiscrimination rules relating to qualified cash or deferred arrangements ("section 401(k) plans") and matching contributions. This special definition applies to an employer incorporated on December 15, 1924, that meets certain specific requirements.

Description of Proposal

The proposal would repeal the special definition of highly compensated employee under the Tax Reform Act of 1986. Thus, the present-law definition would apply.

Effective Date

The proposal would be effective for plan years beginning after December 31, 2001.

4. Employees of tax-exempt entities

Present Law

The Tax Reform Act of 1986 provided that nongovernmental tax-exempt employers were not permitted to maintain a qualified cash or deferred arrangement ("section 401(k) plan"). This prohibition was repealed, effective for years beginning after December 31, 1996, by the Small Business Job Protection Act of 1996.

Treasury regulations provide that, in applying the nondiscrimination rules to a section 401(k) plan (or a section 401(m) plan that is provided under the same general arrangement as the

[51] An employee includes a self-employed individual.

section 401(k) plan), the employer may treat as excludable those employees of a tax-exempt entity who could not participate in the arrangement due to the prohibition on maintenance of a section 401(k) plan by such entities. Such employees may be disregarded only if more than 95 percent of the employees who could participate in the section 401(k) plan benefit under the plan for the plan year.[52]

Tax-exempt charitable organizations may maintain a tax-sheltered annuity (a "section 403(b) annuity") that allows employees to make salary reduction contributions.

Description of Proposal

The Treasury Department would be directed to revise its regulations under section 410(b) to provide that employees of a tax-exempt charitable organization who are eligible to make salary reduction contributions under a section 403(b) annuity may be treated as excludable employees for purposes of testing a section 401(k) plan, or a section 401(m) plan that is provided under the same general arrangement as the section 401(k) plan of the employer if (1) no employee of such tax-exempt entity is eligible to participate in the section 401(k) or 401(m) plan and (2) at least 95 percent of the employees who are not employees of the charitable employer are eligible to participate in such section 401(k) plan or section 401(m) plan.

The revised regulations would be effective for years beginning after December 31, 1996.

Effective Date

The proposal would be effective on the date of enactment.

5. Treatment of employer-provided retirement advice

Present Law

Under present law, certain employer-provided fringe benefits are excludable from gross income (sec. 132) and wages for employment tax purposes. These excludable fringe benefits include working condition fringe benefits and de minimis fringes. In general, a working condition fringe benefit is any property or services provided by an employer to an employee to the extent that, if the employee paid for such property or services, such payment would be allowable as a deduction as a business expense. A de minimis fringe benefit is any property or services provided by the employer the value of which, after taking into account the frequency with which similar fringes are provided, is so small as to make accounting for it unreasonable or administratively impracticable.

In addition, if certain requirements are satisfied, up to $5,250 annually of employer-provided educational assistance is excludable from gross income (sec. 127) and wages. This

[52] Treas. Reg. sec. 1.410(b)-6(g).

exclusion expires with respect to courses beginning after December 31, 2001.[53] Education not excludable under section 127 may be excludable as a working condition fringe.

There is no specific exclusion under present law for employer-provided retirement planning services. However, such services may be excludable as employer-provided educational assistance or a fringe benefit.

Description of Proposal

Qualified retirement planning services provided to an employee and his or her spouse by an employer maintaining a qualified plan would be excludable from income and wages. The exclusion would not apply with respect to highly compensated employees unless the services are available on substantially the same terms to each member of the group of employees normally provided education and information regarding the employer's qualified plan. The exclusion would be intended to allow employers to provide advice and information regarding retirement planning. The exclusion would not be limited to information regarding the qualified plan, and, thus, for example, would apply to advice and information regarding retirement income planning for an individual and his or her spouse and how the employer's plan fits into the individual's overall retirement income plan. On the other hand, the exclusion would not be intended to apply to services that may be related to retirement planning, such as tax preparation, accounting, legal or brokerage services.

Effective Date

The proposal would be effective with respect to taxable years beginning after December 31, 2001.

6. Reporting simplification

Present Law

A plan administrator of a pension, annuity, stock bonus, profit-sharing or other funded plan of deferred compensation generally must file with the Secretary of the Treasury an annual return for each plan year containing certain information with respect to the qualification, financial condition, and operation of the plan. Title I of ERISA also may require the plan administrator to file annual reports concerning the plan with the Department of Labor and the Pension Benefit Guaranty Corporation ("PBGC"). The plan administrator must use the Form 5500 series as the format for the required annual return.[54] The Form 5500 series annual return/report, which consists of a primary form and various schedules, includes the information required to be filed with all three agencies. The plan administrator satisfies the reporting requirement with respect to each agency by filing the Form 5500 series annual return/report with the Department of Labor, which forwards the form to the Internal Revenue Service and the PBGC.

[53] The exclusion does not apply with respect to graduate-level courses.

[54] Treas. Reg. sec. 301.6058-1(a).

The Form 5500 series consists of 2 different forms: Form 5500 and Form 5500-EZ. Form 5500 is the more comprehensive of the forms and requires the most detailed financial information. A plan administrator generally may file Form 5500-EZ, which consists of only one page, if (1) the only participants in the plan are the sole owner of a business that maintains the plan (and such owner's spouse), or partners in a partnership that maintains the plan (and such partners' spouses), (2) the plan is not aggregated with another plan in order to satisfy the minimum coverage requirements of section 410(b), (3) the employer is not a member of a related group of employers, and (4) the employer does not receive the services of leased employees. If the plan satisfies the eligibility requirements for Form 5500-EZ and the total value of the plan assets as of the end of the plan year and all prior plan years does not exceed $100,000, the plan administrator is not required to file a return.

With respect to a plan that does not satisfy the eligibility requirements for Form 5500-EZ, the characteristics and the size of the plan determine the amount of detailed financial information that the plan administrator must provide on Form 5500. If the plan has more than 100 participants at the beginning of the plan year, the plan administrator generally must provide more information.

Description of Proposal

The Secretary of the Treasury would be directed to modify the annual return filing requirements with respect to plans that satisfy the eligibility requirements for Form 5500-EZ to provide that if the total value of the plan assets of such a plan as of the end of the plan year and all prior plan years does not exceed $250,000, the plan administrator is not required to file a return. In addition, the proposal would direct the Secretary of the Treasury and the Secretary of Labor to provide simplified reporting requirements for certain plans with fewer than 25 employees.

Effective Date

The proposal would be effective on January 1, 2002.

7. Improvement to Employee Plans Compliance Resolution System

Present Law

A retirement plan that is intended to be a tax-qualified plan provides retirement benefits on a tax-favored basis if the plan satisfies all of the requirements of section 401(a). Similarly, an annuity that is intended to be a tax-sheltered annuity provides retirement benefits on a tax-favored basis if the program satisfies all of the requirements of section 403(b). Failure to satisfy all of the applicable requirements of section 401(a) or section 403(b) may disqualify a plan or annuity for the intended tax-favored treatment.

The Internal Revenue Service ("IRS") has established the Employee Plans Compliance Resolution System ("EPCRS"), which is a comprehensive system of correction programs for sponsors of retirement plans and annuities that are intended, but have failed, to satisfy the requirements of section 401(a), section 403(a), or section 403(b), as applicable.[55] EPCRS permits employers to correct compliance failures and continue to provide their employees with retirement benefits on a tax-favored basis.

The IRS has designed EPCRS to (1) encourage operational and formal compliance, (2) promote voluntary and timely correction of compliance failures, (3) provide sanctions for compliance failures identified on audit that are reasonable in light of the nature, extent, and severity of the violation, (4) provide consistent and uniform administration of the correction programs, and (5) permit employers to rely on the availability of EPCRS in taking corrective actions to maintain the tax-favored status of their retirement plans and annuities.

The basic elements of the programs that comprise EPCRS are self-correction, voluntary correction with IRS approval, and correction on audit. The Self-Correction Program ("SCP") generally permits a plan sponsor that has established compliance practices to correct certain insignificant failures at any time (including during an audit), and certain significant failures within a 2-year period, without payment of any fee or sanction. The Voluntary Correction Program ("VCP") program permits an employer, at any time before an audit, to pay a limited fee and receive IRS approval of a correction. For a failure that is discovered on audit and corrected, the Audit Closing Agreement Program ("Audit CAP") provides for a sanction that bears a reasonable relationship to the nature, extent, and severity of the failure and that takes into account the extent to which correction occurred before audit.

The IRS has expressed its intent that EPCRS will be updated and improved periodically in light of experience and comments from those who use it.

Description of Proposal

The Secretary of the Treasury would be directed to continue to update and improve EPCRS, giving special attention to (1) increasing the awareness and knowledge of small employers concerning the availability and use of EPCRS, (2) taking into account special concerns and circumstances that small employers face with respect to compliance and correction of compliance failures, (3) extending the duration of the self-correction period under SCP for significant compliance failures, (4) expanding the availability to correct insignificant compliance failures under SCP during audit, and (5) assuring that any tax, penalty, or sanction that is imposed by reason of a compliance failure is not excessive and bears a reasonable relationship to the nature, extent, and severity of the failure.

Effective Date

The proposal would be effective on the date of enactment.

[55] Rev. Proc. 2001-17, 2001-7 I.R.B. 589.

8. Repeal of the multiple use test

Present Law

Elective deferrals under a qualified cash or deferred arrangement ("section 401(k) plan") are subject to a special annual nondiscrimination test ("ADP test"). The ADP test compares the actual deferral percentages ("ADPs") of the highly compensated employee group and the nonhighly compensated employee group. The ADP for each group generally is the average of the deferral percentages separately calculated for the employees in the group who are eligible to make elective deferrals for all or a portion of the relevant plan year. Each eligible employee's deferral percentage generally is the employee's elective deferrals for the year divided by the employee's compensation for the year.

The plan generally satisfies the ADP test if the ADP of the highly compensated employee group for the current plan year is either (1) not more than 125 percent of the ADP of the nonhighly compensated employee group for the prior plan year, or (2) not more than 200 percent of the ADP of the nonhighly compensated employee group for the prior plan year and not more than 2 percentage points greater than the ADP of the nonhighly compensated employee group for the prior plan year.

Employer matching contributions and after-tax employee contributions under a defined contribution plan also are subject to a special annual nondiscrimination test ("ACP test"). The ACP test compares the actual deferral percentages ("ACPs") of the highly compensated employee group and the nonhighly compensated employee group. The ACP for each group generally is the average of the contribution percentages separately calculated for the employees in the group who are eligible to make after-tax employee contributions or who are eligible for an allocation of matching contributions for all or a portion of the relevant plan year. Each eligible employee's contribution percentage generally is the employee's aggregate after-tax employee contributions and matching contributions for the year divided by the employee's compensation for the year.

The plan generally satisfies the ACP test if the ACP of the highly compensated employee group for the current plan year is either (1) not more than 125 percent of the ACP of the nonhighly compensated employee group for the prior plan year, or (2) not more than 200 percent of the ACP of the nonhighly compensated employee group for the prior plan year and not more than 2 percentage points greater than the ACP of the nonhighly compensated employee group for the prior plan year.

For any year in which (1) at least one highly compensated employee is eligible to participate in an employer's plan or plans that are subject to both the ADP test and the ACP test, (2) the plan subject to the ADP test satisfies the ADP test but the ADP of the highly compensated employee group exceeds 125 percent of the ADP of the nonhighly compensated employee group, and (3) the plan subject to the ACP test satisfies the ACP test but the ACP of the highly compensated employee group exceeds 125 percent of the ACP of the nonhighly compensated employee group, an additional special nondiscrimination test ("multiple use test") applies to the elective deferrals, employer matching contributions, and after-tax employee contributions. The plan or plans generally satisfy the multiple use test if the sum of the ADP and the ACP of the highly compensated employee group does not exceed the greater of (1) the sum of (A) 1.25 times the greater of the ADP or the ACP of the nonhighly compensated employee group, and (B) 2 percentage points plus (but not more than 2 times) the lesser of the ADP or the ACP of the nonhighly compensated employee group, or (2) the sum of (A) 1.25 times the lesser of the ADP or the ACP of the nonhighly compensated employee group, and (B) 2 percentage points plus (but not more than 2 times) the greater of the ADP or the ACP of the nonhighly compensated employee group.

Description of Proposal

The proposal would repeal the multiple use test.

Effective Date

The proposal would be effective for years beginning after December 31, 2001.

9. Flexibility in nondiscrimination and line of business rules

Present Law

A plan is not a qualified retirement plan if the contributions or benefits provided under the plan discriminate in favor of highly compensated employees (sec. 401(a)(4)). The applicable Treasury regulations set forth the exclusive rules for determining whether a plan satisfies the nondiscrimination requirement. These regulations state that the form of the plan and the effect of the plan in operation determine whether the plan is nondiscriminatory and that intent is irrelevant.

Similarly, a plan is not a qualified retirement plan if the plan does not benefit a minimum number of employees (sec. 410(b)). A plan satisfies this minimum coverage requirement if and only if it satisfies one of the tests specified in the applicable Treasury regulations. If an employer is treated as operating separate lines of business, the employer may apply the minimum coverage requirements to a plan separately with respect to the employees in each separate line of business (sec. 414(r)). Under a so-called "gateway" requirement, however, the plan must benefit a classification of employees that does not discriminate in favor of highly compensated employees in order for the employer to apply the minimum coverage requirements separately for the employees in each separate line of business. A plan satisfies this gateway requirement only if it satisfies one of the tests specified in the applicable Treasury regulations.

Description of Proposal

The Secretary of the Treasury would be directed to modify, on or before December 31, 2003, the existing regulations issued under section 414(r) in order to expand (to the extent that the Secretary may determine to be appropriate) the ability of a plan to demonstrate compliance with the line of business requirements based upon the facts and circumstances surrounding the design and operation of the plan, even though the plan is unable to satisfy the mechanical tests currently used to determine compliance.

The Secretary of the Treasury would be directed to provide by regulation applicable to years beginning after December 31, 2003, that a plan is deemed to satisfy the nondiscrimination requirements of section 401(a)(4) if the plan satisfies the pre-1994 facts and circumstances test, satisfies the conditions prescribed by the Secretary to appropriately limit the availability of such test, and is submitted to the Secretary for a determination of whether it satisfies such test (to the extent provided by the Secretary).

Similarly, a plan would comply with the minimum coverage requirement of section 410(b) if the plan satisfies the pre-1989 coverage rules, is submitted to the Secretary for a determination of whether it satisfies the pre-1989 coverage rules (to the extent provided by the Secretary), and satisfies conditions prescribed by the Secretary by regulation that appropriately limit the availability of the pre-1989 coverage rules.

Effective Date

The proposals relating to the line of business requirements under section 414(r) and the nondiscrimination requirements under section 401(a)(4) would be effective on the date of enactment. The proposal relating to the minimum coverage requirements under section 410(b) would be effective for years beginning after December 31, 2003, except that any condition of availability prescribed by the Secretary by regulation would not apply before the first year beginning not less than 120 days after the date on which such condition is prescribed.

10. Extension to all governmental plans of moratorium on application of certain nondiscrimination rules applicable to State and local government plans

Present Law

A qualified retirement plan maintained by a State or local government is exempt from the rules concerning nondiscrimination (sec. 401(a)(4)) and minimum participation (sec. 401(a)(26)). All other governmental plans are not exempt from the nondiscrimination and minimum participation rules.

Description of Proposal

The proposal would exempt all governmental plans (as defined in sec. 414(d)) from the nondiscrimination and minimum participation rules.

Effective Date

The proposal would be effective for plan years beginning after December 31, 2001.

11. Notice and consent period regarding distributions

Present Law

Notice and consent requirements apply to certain distributions from qualified retirement plans. These requirements relate to the content and timing of information that a plan must provide to a participant prior to a distribution, and to whether the plan must obtain the participant's consent to the distribution. The nature and extent of the notice and consent requirements applicable to a distribution depend upon the value of the participant's vested accrued benefit and whether the joint and survivor annuity requirements (sec. 417) apply to the participant.[56]

If the present value of the participant's vested accrued benefit exceeds $5,000, the plan may not distribute the participant's benefit without the written consent of the participant. The participant's consent to a distribution is not valid unless the participant has received from the plan a notice that contains a written explanation of (1) the material features and the relative values of the optional forms of benefit available under the plan, (2) the participant's right, if any, to have the distribution directly transferred to another retirement plan or IRA, and (3) the rules concerning the taxation of a distribution. If the joint and survivor annuity requirements apply to the participant, this notice also must contain a written explanation of (1) the terms and conditions of the qualified joint and survivor annuity ("QJSA"), (2) the participant's right to make, and the effect of, an election to waive the QJSA, (3) the rights of the participant's spouse with respect to a participant's waiver of the QJSA, and (4) the right to make, and the effect of, a revocation of a waiver of the QJSA. The plan generally must provide this notice to the participant no less than 30 and no more than 90 days before the date distribution commences.

If the participant's vested accrued benefit does not exceed $5,000, the terms of the plan may provide for distribution without the participant's consent. The plan generally is required, however, to provide to the participant a notice that contains a written explanation of (1) the participant's right, if any, to have the distribution directly transferred to another retirement plan or IRA, and (2) the rules concerning the taxation of a distribution. The plan generally must provide this notice to the participant no less than 30 and no more than 90 days before the date distribution commences.

Description of Proposal

A qualified retirement plan would be required to provide the applicable distribution notice no less than 30 days and no more than 180 days before the date distribution commences. The Secretary of the Treasury would be directed to modify the applicable regulations to reflect the extension of the notice period to 180 days and to provide that the description of a participant's right, if any, to defer receipt of a distribution shall also describe the consequences of failing to defer such receipt.

Effective Date

The proposal would be effective for years beginning after December 31, 2001.

[56] Similar provisions are contained in Title I of ERISA.

F. Other ERISA Provisions

1. Extension of PBGC missing participants program

Present Law

The plan administrator of a defined benefit pension plan that is subject to Title IV of ERISA, is maintained by a single employer, and terminates under a standard termination is required to distribute the assets of the plan. With respect to a participant whom the plan administrator cannot locate after a diligent search, the plan administrator satisfies the distribution requirement only by purchasing irrevocable commitments from an insurer to provide all benefit liabilities under the plan or transferring the participant's designated benefit to the Pension Benefit Guaranty Corporation ("PBGC"), which holds the benefit of the missing participant as trustee until the PBGC locates the missing participant and distributes the benefit.

The PBGC missing participant program is not available to multiemployer plans or defined contribution plans and other plans not covered by Title IV of ERISA.

Description of Proposal

The proposal would direct the PBGC to prescribe for terminating multiemployer plans rules similar to the present-law missing participant rules applicable to terminating single employer plans that are subject to Title IV of ERISA.

Effective Date

The proposal would be effective for distributions from terminating plans that occur after the PBGC has adopted final regulations implementing the proposal.

2. Reduce PBGC premiums for small and new plans

Present Law

Under present law, the Pension Benefit Guaranty Corporation ("PBGC") provides insurance protection for participants and beneficiaries under certain defined benefit pension plans by guaranteeing certain basic benefits under the plan in the event the plan is terminated with insufficient assets to pay benefits promised under the plan. The guaranteed benefits are funded in part by premium payments from employers who sponsor defined benefit plans. The amount of the required annual PBGC premium for a single-employer plan is generally a flat rate premium of $19 per participant and an additional variable-rate premium based on a charge of $9 per $1,000 of unfunded vested benefits. Unfunded vested benefits under a plan generally means (1) the unfunded current liability for vested benefits under the plan, over (2) the value of the plan's assets, reduced by any credit balance in the funding standard account. No variable-rate premium is imposed for a year if contributions to the plan were at least equal to the full funding limit.

The PBGC guarantee is phased in ratably in the case of plans that have been in effect for less than 5 years, and with respect to benefit increases from a plan amendment that was in effect for less than 5 years before termination of the plan.

Description of Proposal

Reduced flat-rate premiums for new plans of small employers

Under the proposal, for the first five plan years of a new single-employer plan of a small employer, the flat-rate PBGC premium would be $5 per plan participant.

A small employer is a contributing sponsor that, on the first day of the plan year, has 100 or fewer employees. For this purpose, all employees of the members of the controlled group of the contributing sponsor are taken into account. In the case of a plan to which more than one unrelated contributing sponsor contributes, employees of all contributing sponsors (and their controlled group members) are taken into account in determining whether the plan is a plan of a small employer.

A new plan means a defined benefit plan maintained by a contributing sponsor if, during the 36-month period ending on the date of adoption of the plan, such contributing sponsor (or controlled group member or a predecessor of either) has not established or maintained a plan subject to PBGC coverage with respect to which benefits were accrued for substantially the same employees as are in the new plan.

Reduced variable-rate PBGC premium for new plans

The proposal would provide that the variable-rate premium is phased in for new defined benefit plans over a six-year period starting with the plan's first plan year. The amount of the variable-rate premium would be a percentage of the variable premium otherwise due, as follows: 0 percent of the otherwise applicable variable-rate premium in the first plan year; 20 percent in the second plan year; 40 percent in the third plan year; 60 percent in the fourth plan year; 80 percent in the fifth plan year; and 100 percent in the sixth plan year (and thereafter).

A new defined benefit plan is defined as described above under the flat-rate premium proposal relating to new small employer plans.

Reduced variable-rate PBGC premium for small plans

In the case of a plan of a small employer, the variable-rate premium would be no more than $5 multiplied by the number of plan participants in the plan at the end of the preceding plan year. For purposes of the proposal, a small employer is a contributing sponsor that, on the first day of the plan year, has 25 or fewer employees. For this purpose, all employees of the members of the controlled group of the contributing sponsor are taken into account. In the case of a plan to which more than one unrelated contributing sponsor contributes, employees of all contributing sponsors (and their controlled group members) are taken into account in determining whether the plan is a plan of a small employer.

Effective date

The reduction of the flat-rate premium for new plans of small employers and the reduction of the variable-rate premium for new plans would be effective with respect to plans established after December 31, 2001. The reduction of the variable-rate premium for small plans would be effective with respect to plan years beginning after December 31, 2001.

3. Authorization for PBGC to pay interest on premium overpayment refunds

Present Law

The PBGC charges interest on underpayments of premiums, but is not authorized to pay interest on overpayments.

Description of Proposal

The proposal would allow the PBGC to pay interest on overpayments made by premium payors. Interest paid on overpayments would be calculated at the same rate and in the same manner as interest is charged on premium underpayments.

Effective Date

The proposal would be effective with respect to interest accruing for periods beginning not earlier than the date of enactment.

4. Rules for substantial owner benefits in terminated plans

Present Law

Under present law, the Pension Benefit Guaranty Corporation ("PBGC") provides participants and beneficiaries in a defined benefit pension plan with certain minimal guarantees as to the receipt of benefits under the plan in case of plan termination. The employer sponsoring the defined benefit pension plan is required to pay premiums to the PBGC to provide insurance for the guaranteed benefits. In general, the PBGC will guarantee all basic benefits which are payable in periodic installments for the life (or lives) of the participant and his or her beneficiaries and are non-forfeitable at the time of plan termination. The amount of the guaranteed benefit is subject to certain limitations. One limitation is that the plan (or an amendment to the plan which increases benefits) must be in effect for 60 months before termination for the PBGC to guarantee the full amount of basic benefits for a plan participant, other than a substantial owner. In the case of a substantial owner, the guaranteed basic benefit is phased in over 30 years beginning with participation in the plan. A substantial owner is one who owns, directly or indirectly, more than 10 percent of the voting stock of a corporation or all the stock of a corporation. Special rules restricting the amount of benefit guaranteed and the allocation of assets also apply to substantial owners.

Description of Proposal

The proposal would provide that the 60-month phase-in of guaranteed benefits would apply to a substantial owner with less than 50 percent ownership interest. For a substantial owner with a 50 percent or more ownership interest ("majority owner"), the phase-in would depend on the number of years the plan has been in effect. The majority owner's guaranteed benefit would be limited so that it could not be more than the amount phased in over 60 months for other participants. The rules regarding allocation of assets would apply to substantial owners, other than majority owners, in the same manner as other participants.

Effective Date

The proposal would be effective for plan terminations with respect to which notices of intent to terminate are provided, or for which proceedings for termination are instituted by the PBGC, after December 31, 2001.

G. Provisions Relating to Plan Amendments

Present Law

Plan amendments to reflect amendments to the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs.

Description of Proposal

Any amendments to a plan or annuity contract required to be made by the proposal would not be required to be made before the last day of the first plan year beginning on or after January 1, 2004. In the case of a governmental plan, the date for amendments would be extended to the last day of the first plan year beginning on or after January 1, 2006. The delayed amendment date would not apply to any amendment required or permitted by the proposal unless, during the period beginning on the date the applicable section of the proposal takes effect and ending on the delayed amendment date, (1) the plan or annuity contract is operated as if such amendment were in effect, and (2) such amendment applies retroactively for such period.

Effective Date

The proposal would be effective on the date of enactment.