DESCRIPTION OF H.R. 5558, THE "RETIREMENT SAVINGS AND SECURITY ACT OF 2002"

Scheduled for Markup
by the House Committee on Ways and Means

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The House Committee on Ways and Means has scheduled a markup of H.R. 5558, the "Retirement Savings and Security Act of 2002" on October 7, 2002. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the bill.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of H.R. 5558, the "Retirement Savings and Security Act of 2002"* (JCX-98-02), October 7, 2002.

A. Acceleration of Increases in IRA Contribution Limit

Present Law

Under present law, the maximum annual limit on contributions to individual retirement arrangements ("IRAs") is $3,000 for 2002-2004, $4,000 for 2005-2007, and $5,000 for 2008[2] and thereafter. The $5,000 limit is indexed for inflation after 2008.

For individuals who have attained age 50, the maximum annual limit on IRA contributions is increased by $500 in 2002-2005 and $1,000 in 2006 and thereafter.[3]

Description of Proposal

The proposal accelerates the increase in the maximum annul limit on contributions so that the limit is $5,000 for 2003 and thereafter. The proposal also accelerates the increase in the catch-up contribution limit so that it is $1,000 in 2003 and thereafter. The $5,000 limit is indexed for inflation after 2008, as under present law.[4]

Effective Date

The provision is effective for taxable years beginning after December 31, 2002.

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[2] For years after 2010, the limit is $2,000, pursuant to the general sunset provision of the Economic Growth and Tax Relief Reconciliation Act of 2001.

[3] For years after 2010, the catch-up limit is $0, pursuant to the general sunset provision of the Economic Growth and Tax Relief Reconciliation Act of 2001.

[4] These provisions are permanent.

B. Acceleration of Scheduled Increases in Pension Plan Contribution Limits

Present Law

The annual dollar limit on elective deferrals under qualified cash or deferred arrangements (sec. 401(k)), tax-sheltered annuities (sec. 403(b)), and salary reduction simplified employee pensions ("SEPs") is $11,000 in 2002. This limit is scheduled to increase so that it is $15,000 in 2006, with indexing thereafter.

The maximum annual elective deferrals that may be made to a SIMPLE plan is $7,000 in 2002. This limit is scheduled to increase so that it is $10,000 in 2005, with indexing thereafter.

The dollar limit on deferrals under an eligible deferred compensation plan of a tax-exempt or State or local government employer (sec. 457) is $11,000 in 2002. This limit is scheduled to increase until it is $15,000 in 2006, with indexing thereafter.

Present law provides that individuals who have attained age 50 may make additional catch-up contributions to qualified cash or deferred arrangements, tax-sheltered annuities, salary reduction SEPs, and section 457 plans of up to $1,000 in 2002. This amount is scheduled to increase to $5,000 in 2006, with indexing thereafter. Individual who have attained age 50 may make additional catch-up contributions to a SIMPLE plan of up to $500 in 2002. This amount is scheduled to increase to $2,500 in 2006, with indexing thereafter.[5]

Description of Proposal

The proposal increases the limit on elective deferrals generally to $15,000, increases the limit on elective deferrals under SIMPLE plans to $10,000, and increases the dollar limit on deferrals under a section 457 plan to $15,000. These dollar amounts are indexed for inflation after 2006, as under present law.

The proposal increases the maximum catch-up contribution for qualified cash or deferred arrangements, tax-sheltered annuities, salary reduction SEPs, and section 457 plans to $5,000 and increases the maximum catch-up contribution for SIMPLE plans to $2,500.[6] These dollar amounts are indexed for inflation after 2006, as under present law.

Effective Date

The provision is effective for years beginning after December 31, 2002.

[5] For years after 2010, the limits revert to the limits in effect prior the Economic Growth and Tax Relief Reconciliation Act of 2001 pursuant to the general sunset provision of that Act.

[6] The changes made by the provision are permanent.

C. Updating of the Minimum Distribution Rules

Present Law

In general

Minimum distribution rules apply to all types of tax-favored retirement arrangements, including qualified retirement plans and annuities, individual retirement arrangements ("IRAs"), tax-sheltered annuity plans ("section 403(b) plans"), 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 may be waived if the individual establishes to the satisfaction of the Secretary of the Treasury that the shortfall in the amount distributed was due to reasonable error and reasonable steps are being taken to remedy the shortfall. Under certain circumstances following the death of a participant, the excise tax is automatically waived under Treasury regulations.

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 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 from account-type arrangements (e.g., a defined contribution plan or an individual retirement account), life expectancies of the participant and the participant's spouse generally may be recomputed annually.

In the case of qualified retirement plans and annuities, section 403(b) plans, and section 457 plans, the required beginning date generally is April 1 of the calendar year following the later of (1) the calendar year in which the participant attains age 70-1/2 or (2) the calendar year in which the participant retires. However, in the case of a five-percent owner of the employer, distributions generally are required to begin no later than April 1 of the calendar year following the year in which the five-percent owner attains age 70-1/2. If commencement of distributions from a defined benefit plan is delayed beyond age 70-1/2 (i.e., in the case of a participant who has not retired), then the accrued benefit of the participant must be actuarially increased to take into account the period after age 70-1/2 in which the participant was not receiving benefits under the plan.[7] In the case of distributions from an IRA other than a Roth

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

IRA, the required beginning date is the April 1 of the calendar year 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 Treasury regulations, in order to satisfy the minimum distribution rules, annuity payments under a defined benefit plan must be paid in periodic 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 an amount from the uniform table provided in the regulations.

Distributions after the death of the plan participant

The minimum distribution rules also apply to distributions to beneficiaries of deceased participants. In general, if a 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 five years of the participant's death. The five-year rule does not apply if distributions begin within one 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 distributions until the date the deceased participant would have attained age 70-1/2. In addition, a surviving spouse generally has the option of rolling over his or her interest in the plan or IRA to a plan in which the spouse is a participant or to an IRA established for his or her benefit. In that case, the minimum distribution rules are applied to the plan or IRA on the basis of the surviving spouse's age.

Description of Proposal

The proposal increases the age at which distributions to a participant must begin to 73 in 2003 and 2004, 74 in 2005 and 2006, and 75 in 2007 and thereafter. As a result, a participant generally is not required to begin receiving distributions until April 1 of the calendar year following the later of (1) the calendar year in which the participant attains the applicable age or (2) the calendar year in which the participant retires. In the case of a five-percent owner of the employer, distributions are required to begin no later than April 1 of the calendar year following the year in which the five-percent owner attains the applicable age.

The proposal revises the rule relating to actuarial adjustments to the accrued benefit under a defined benefit plan when commencement of benefits is delayed beyond age 70-1/2. Under the proposal, a participant's accrued benefit under a defined benefit plan must be actuarially increased to take into account the period during which the participant is not eligible to receive benefits under the plan. For this purpose, the relevant period begins April 1 following the calendar year in which the participant attains age 70-1/2.

The proposal does not increase the age for purposes of making distributions to a surviving spouse. Accordingly, as under present law, distributions to a surviving spouse beneficiary must begin by the date the deceased participant would have attained age 70-1/2.

Effective Date

The provision is effective for years beginning after December 31, 2002. Under a transition rule, a plan or IRA is not treated as failing to meet the minimum distribution requirements merely because, in years after 2002, it does not make a distribution before a participant's required beginning date as determined under the proposal. As a result, a participant who attains age 70-1/2 before 2003 need not receive distributions in years after 2002 until his or her required beginning date under the proposal. For example, a participant who attains age 70-1/2 in 2002 and who is required under present law to receive a distribution by April 1, 2003, may delay the distribution until his or her required beginning date as determined under the proposal. In addition, a participant who began receiving required distributions before 2003 and whose required beginning date under the proposal is after 2004, is not required to receive additional distributions until that required beginning date.