OVERVIEW OF PRESENT-LAW TAX RULES AND ISSUES RELATING TO EMPLOYER-SPONSORED RETIREMENT PLANS

Scheduled for a Public Hearing

Before the

SUBCOMMITTEE ON OVERSIGHT

of the

HOUSE COMMITTEE ON WAYS AND MEANS

on March 23, 1999

Prepared by the Staff

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INTRODUCTION

The Subcommittee on Oversight of the Committee on Ways and Means has scheduled a public hearing on March 23, 1999, on pension issues.

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of present law and a discussion of issues relating to simplification of the Federal income tax rules applicable to tax-qualified retirement plans. Part I of the pamphlet is a summary. This is followed by a description of the present-law Federal tax rules regarding tax-qualified plans and similar arrangements (Part II), and a discussion of pension plan tax law simplification issues (Part III).

[1] This document may be cited as follows: Joint Committee on Taxation, *Overview of Present-Law Tax Rules and Issues Relating to Employer-Sponsored Retirement Plans* (JCX-16-99), March 22, 1999.

I. SUMMARY

Present-law rules relating to qualified plans

A plan of deferred compensation that meets the qualification standards of the Internal Revenue Code (a "qualified plan") is accorded special tax treatment under present law. The employer maintaining the plan is entitled to a current deduction (within limits) for contributions to a qualified plan even though an employee is not required to include qualified plan benefits in income until the benefits are distributed from the plan. The general purpose of the tax benefits for qualified plans is to encourage employers to establish broad-based retirement plans for their employees.

Qualified plans are broadly classified into two categories: defined contribution plans and defined benefit pension plans. There are several different types of defined contribution plans, including money purchase pension plans, profit-sharing plans, stock bonus plans, and employee stock ownership plans ("ESOPs"). An increasingly popular type of defined contribution plan is a qualified cash or deferred arrangement, often called a "section 401(k) plan" after the governing Code section.

One of the main purposes of the qualification standards and related rules governing qualified plans is to ensure that qualified plans benefit an employer's rank-and-file employees as well as the employer's highly compensated employees. The qualification standards also define minimum rights of plan participants and beneficiaries and provide limits on the tax deferral possible under qualified plans.

The qualification rules include minimum participation rules that limit the age and service requirements an employer can impose as a requirement of participation in a plan; coverage and nondiscrimination rules designed to prevent qualified plans from discriminating in favor of highly compensated employees; vesting and accrual rules which limit the period of service an employer can require before an employee earns or becomes entitled to a benefit under a plan; limitations on the contributions made on behalf of and benefits of a plan participant; and minimum funding rules designed to ensure the solvency of defined benefit pension plans. The Code also contains rules regarding the taxation of qualified plan benefits and rules designed to prevent plan fiduciaries and others closely associated with a plan from misusing plan assets.

The present-law rules governing qualified plans originated in the Employee Retirement Income Security Act of 1974 ("ERISA").[2] ERISA forms the basis for the current private pension system. The rules enacted in ERISA have been revised several times. The modifications have had a variety of purposes, including ensuring broader pension plan coverage, providing greater benefit security for participants in defined benefit plans, modifying the rights of plan participants,

[2] Qualified plans are also subject to regulation under the labor law provisions of Titles I and IV of ERISA.

and simplification. The Small Business Job Protection Act of 1996 contained comprehensive pension simplification provisions. These provisions included significant changes to the rules regarding taxation of distributions and nondiscrimination, including the addition of a new type of plan for small employers (called the "SIMPLE") and a design-based safe harbor plan for cash or deferred arrangements. The Taxpayer Relief Act of 1997 also contained a variety of pension simplification provisions, including provisions to simplify plan administration.

Other types of employer-sponsored retirement plans

Other types of arrangements provide retirement benefits similar to those offered under qualified plans. These include simplified employee pensions ("SEPs"), tax-sheltered annuities ("section 403(b) annuities"), and section 457 plans maintained by tax-exempt and governmental employers.

Simplification issues

The Federal laws and regulations governing employer-provided retirement benefits are recognized as among the most complex set of rules applicable to any area of the tax law. There are several sources for this complexity, including the interaction of retirement policy and tax policy, the volume and frequency of employee benefits legislation, the structure of the workplace, the need to take into account the great variety of compensation and benefit packages, the desire for certainty in the law, and transition rules.

In analyzing any proposal to simplify the pension rules, the following issues are important: (1) the extent to which the proposed change is consistent with the underlying policy objectives of the rule that is altered; (2) whether a complete revision of rules that employers and plan administrators understand and use should be made solely in the interest of simplification; (3) whether additional legislation with respect to a rule that has already been subject to significant legislation itself creates complexity; (4) the extent to which transition rules and "grandfather" rules contribute to complexity; and (5) whether any attempt to simplify the rules relating to employer-provided pension plans should be required to be revenue neutral with respect to present law.

II. PRESENT-LAW RULES[3]

A. Overview of Qualified Plans and Similar Arrangements

Qualified plans

A plan of deferred compensation that meets the qualification standards of the Internal Revenue Code (a "qualified plan") is accorded special tax treatment under present law. Employees do not include qualified plan benefits in gross income until the benefits are distributed even though the plan is funded and the benefits are nonforfeitable. Tax deferral is provided under qualified plans from the time contributions are made until the time benefits are received. The employer is entitled to a current deduction (within limits) for contributions to a qualified plan even though an employee's income inclusion is deferred. Contributions to a qualified plan are held in a tax-exempt trust.

The special tax benefits for qualified plans and qualified plan benefits represent a significant tax expenditure. For fiscal year 1999, the tax expenditure for the net exclusion for pension contributions and earnings is estimated to be $76.1 billion.[4]

The policy rationale for this tax expenditure is that the tax benefits for qualified plans encourage employers to provide retirement benefits for their employees. This reduces the need for public assistance and reduces pressure on the Social Security system.

A primary purpose of the qualification standards and related rules governing qualified plans is to ensure that qualified plans benefit an employer's rank-and-file employees as well as highly compensated employees. They also define the rights of plan participants and beneficiaries and provide some limit on the tax benefits for qualified plans.

Qualified plans are broadly classified into two categories based on the nature of the benefits provided: defined contribution plans and defined benefit pension plans.

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[3] This document is limited to a discussion of the Internal Revenue Code rules relating to tax-qualified retirement plans. In addition to the rules in the Internal Revenue Code, the labor law provisions of Title I of ERISA contain extensive rules regarding employee benefit pension plans, including rules regarding disclosure to employees and standards of conduct applicable to plan fiduciaries. There is some overlap between provisions of the Code and Title I of ERISA. Title IV of ERISA contains rules regarding terminations of defined benefit pension plans.

[4] See Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 1999-2003* (JCS-7-98), December 14, 1998.

Under a defined benefit pension plan, benefit levels are specified under a plan formula. Benefits under a defined benefit pension plan are funded by the general assets of the trust established under the plan; individual accounts are not maintained for employees participating in the plan.[5]

Benefits under defined contribution plans are based solely on the contributions (and earnings thereon) allocated to separate accounts maintained for each plan participant. There are several different types of defined contribution plans, including money purchase pension plans, target benefit plans, profit-sharing plans, stock bonus plans, and employee stock ownership plans ("ESOPs"). A profit-sharing or stock bonus plan, a pre-ERISA money purchase pension plan, or a rural cooperative plan may include a qualified cash or deferred arrangement (a "section 401(k) plan"). Under such an arrangement, 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. The various different types of plans are in part historical and reflect the various different ways in which employers structure deferred compensation programs for their employees.

SIMPLE retirement plans

Under present law, certain small businesses can establish a simplified retirement plan called the savings incentive match plan for employees ("SIMPLE") retirement plan. SIMPLE plans can be adopted by employers who employ 100 or fewer employees who received at least $5,000 in compensation during the preceding year and who do not provide contributions or benefits for the year under another employer-sponsored retirement plan. A SIMPLE plan can be either an IRA for each employee or part of a section 401(k) plan. If established in IRA form, a SIMPLE plan is not subject to the nondiscrimination rules generally applicable to qualified plans (including the top-heavy rules) and simplified reporting requirements apply. If established as part of a 401(k) plan, the SIMPLE does not have to satisfy the special nondiscrimination tests applicable to 401(k) plans and is not subject to the top-heavy rules. The other qualified plan rules continue to apply. Within limits, contributions to a SIMPLE plan are not taxable until withdrawn.

A SIMPLE retirement plan allows employees to make elective contributions which cannot exceed $6,000 (for 1999). The $6,000 dollar limit is indexed for inflation in $500 increments. The employer is required to satisfy one of two contribution formulas. Under the matching contribution formula, the employer generally is required to match employee elective contributions on a dollar-for-dollar basis up to 3 percent of the employee's compensation. Under a special rule applicable to SIMPLE IRAs, the employer can elect a lower percentage matching contribution for all employees (but not less than 1 percent of each employee's compensation). In addition, a lower percentage cannot be elected for more than 2 out of any 5 years.

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[5] Individual accounts may be maintained for after-tax employee contributions made to a defined benefit pension plan.

Alternatively, for any year, an employer is permitted to elect, in lieu of making matching contributions, to make a 2 percent of compensation nonelective contribution on behalf of each eligible employee with at least $5,000 in compensation for such year, whether or not the employee makes an elective contribution.

No contributions other than employee elective contributions, required employer matching contributions or employer nonelective contributions can be made to a SIMPLE plan. All contributions to an employee's SIMPLE account must be fully vested.

Contributions to a SIMPLE plan generally are deductible by the employer and excludable from the employee's income. Early withdrawals from a SIMPLE plan generally are subject to the 10-percent early withdrawal tax. However, in the case of a SIMPLE IRA, withdrawals of contributions during the 2-year period beginning on the date the employee first participated in the SIMPLE IRA are subject to a 25-percent early withdrawal tax.

Simplified employee pensions ("SEPs")

A simplified employee pension ("SEP") is an IRA to which employers may make contributions up to the limits applicable to defined contribution plans. The employee is always 100-percent vested in employer contributions. All employees who satisfy certain participation requirements must be eligible to participate in the SEP. An employee satisfies the participation requirements if the employee (1) has attained age 21, (2) has performed services for the employer during at least 3 of the immediately preceding 5 years, and (3) received at least $400 (for 1999) in compensation from the employer for the year. Contributions to a SEP generally must bear a uniform relationship to compensation. An employee can participate even though he or she is also a participant in one or more other qualified retirement plans sponsored by the employer. However, SEP contributions are added to the employer's contribution to the other plans on the participant's behalf in applying the limits on contributions and benefits.

Effective for taxable years beginning before January 1, 1997, certain small employers could maintain a salary reduction SEP ("SARSEP") under which employees could elect to have contributions made to the plan or to receive the contributions in cash. The SARSEP rules were generally repealed with the adoption of SIMPLE plans. However, employers may continue to make contributions to SARSEPs that were established before 1997 (in accordance with the rules in effect before 1997). In addition, employees hired after December 31, 1996, may participate in SARSEPs established by their employers prior to January 1, 1997.

Tax-sheltered annuities ("section 403(b) annuities")

Tax-sheltered annuities ("section 403(b) annuities") are another form of employer-based retirement plan that provide the same tax benefits as qualified plans and IRAs. Employers may contribute to such annuities on behalf of their employees, and employees may contribute on a pre-tax basis through salary reduction. Tax-sheltered annuities are subject to rules similar to some of the rules applicable to qualified plans. Tax-sheltered annuity plans may be maintained only by certain types of organizations, in particular, tax-exempt charitable organizations and educational institutions.

The annual contribution to a tax-sheltered annuity generally cannot exceed the lesser of the exclusion allowance or the limit applicable to defined contribution qualified plans. 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 to have one of several special rules apply 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.

Employer contributions to a section 403(b) annuity are generally subject to the same nondiscrimination rules as contributions to qualified plans. Contributions made by the employee under a salary reduction agreement (i.e., contributions that are comparable to employee elective deferrals under a section 401(k) plan) are not subject to nondiscrimination rules similar to those applicable to section 401(k) plans. Instead, all employees generally must be eligible to make salary reduction contributions. Certain employees may be disregarded for purposes of this rule.[6]

Eligible deferred compensation plans of State and local governments and tax-exempt entities ("section 457 plans")

Compensation deferred under an eligible deferred compensation plan (a "section 457 plan") of a tax-exempt or State or local governmental employer is includible in income when paid or made available. The maximum annual deferral under such a plan generally is the lesser of (1) $8,000 (for 1999) or (2) 33-1/3 percent of compensation (net of the deferral).

In general, amounts deferred under a section 457 plan may not be made available to a plan participant before the earlier of (1) the calendar year in which the participant attains age 70-1/2, (2) when the participant is separated from service with the employer, or (3) when the participant is faced with an unforeseeable emergency. Amounts that are made available upon separation from service are includible in gross income in the taxable year in which they are made available.

Amounts deferred under a governmental section 457 plan must be held in trust. Amounts deferred under a section 457 plan of a tax-exempt entity must remain the property of the employer, subject only to the claims of the employer's general creditors.

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[6] As with qualified plans, State and local governmental tax-sheltered annuities are not subject to nondiscrimination rules.

With certain exceptions, section 457 generally applies to all deferred compensation of employees of tax-exempt and State and local governmental employers other than compensation deferred under a qualified plan (or a tax-sheltered annuity). Section 457 does not apply to any bona fide vacation, sick leave, compensatory time, severance pay, disability pay, or death benefit plan. In addition, section 457 does not apply to qualified governmental excess benefit plans that provide benefits in excess of those that are provided under a qualified plan maintained by the governmental employer.

Section 457 plans are not qualified retirement plans; rather, such plans have traditionally been more like unfunded, nonqualified deferred compensation arrangements of private, taxable employers. Present law does not limit the amount of deferred compensation payable under nonqualified deferred compensation plans of taxable employers because there is tension between the employer and the employee–employers generally want a current deduction for compensation, whereas deferred compensation is not deductible until includible in employees' income. This tension is not present in the case of deferred compensation plans of tax-exempt and governmental employers. Thus, section 457 limits the amount that can be deferred under such plans and provides other rules regarding such plans.

Section 457 plans do not benefit from all the favorable tax rules applicable to qualified plans because section 457 plans generally have not been subject to all of the same restrictions and rules as qualified plans (e.g., the maximum permitted annual deferral is lower). However, recent changes in the rules relating to section 457 plans of governmental employers have blurred the distinction between governmental section 457 plans and governmental qualified plans. In particular, assets of governmental section 457 plans must now be held in trust, and governmental qualified plans are not subject to nondiscrimination rules.

B. Plan Qualification Requirements

1. Coverage and nondiscrimination requirements

Key among the qualification standards are coverage and nondiscrimination rules designed to ensure that qualified plans benefit a significant portion of an employer's rank-and-file employees compared to the portion of highly compensated employees benefiting under the plan. These rules include numerical minimum coverage rules (sec. 410(b)), a minimum participation rule requiring that a defined benefit pension plan benefit a minimum number of employees (sec. 401(a)(26)), and a general nondiscrimination requirement (sec. 401(a)(4)). Special nondiscrimination rules apply to qualified cash or deferred arrangements, employer matching contributions, and after-tax employee contributions. For purposes of applying the nondiscrimination rules, the maximum amount of compensation that may be taken into account is $160,000 (for 1998). The employer may elect to aggregate certain plans for purposes of the nondiscrimination rules. In addition, the employer can apply the rules separately to separate lines of business. Under present law, State and local governmental plans are exempt from the nondiscrimination and minimum participation rule.

a. Minimum coverage rules

A plan is not a qualified plan unless the plan satisfies at least one of the following requirements: (1) the plan benefits at least 70 percent of all nonhighly compensated employees ("percentage test"); (2) the plan benefits a percentage of nonhighly compensated employees which is at least 70 percent of the percentage of highly compensated employees benefitting under the plan ("ratio test"); or (3) the average benefits test. A plan meets the average benefits test if: (1) the plan benefits such employees as qualify under a classification set up by the employer that is not discriminatory in favor of highly compensated employees ("classification test"); and (2) the average benefit percentage for nonhighly compensated employees of the employer is at least 70 percent of the average benefit percentage for highly compensated employees of the employer. In general, for purposes of satisfying any of the tests, the exclusion from consideration of employees who have not satisfied certain minimum age and service requirements is permitted.

b. Minimum participation rule

A defined benefit plan is not a qualified plan unless it benefits no fewer than the lesser of (1) 50 employees of the employer or (2) the greater of (a) 40 percent of all employees of the employer or (b) 2 employees (1 employee if there is only 1 employee) (sec. 401(a)(26)). This requirement may not be satisfied by aggregating comparable plans, but may be applied separately to different lines of business of the employer.

The minimum participation rule was enacted in the Tax Reform Act of 1986 because the Congress believed that it was inappropriate to permit an employer to maintain multiple plans, each of which covered a very small number of employees. Although plans that are aggregated for nondiscrimination purposes are required to satisfy comparability requirements with respect to the amount of contributions or benefits, such an arrangement may still discriminate in favor of highly compensated employees.

c. Nondiscrimination in contributions or benefits

A qualified plan may not discriminate in favor of highly compensated employees with respect to contributions or benefits under the plan (sec. 401(a)(4)). This general nondiscrimination requirement applies to all plan aspects, including those not addressed under the numerical coverage tests. Thus, it may apply not only with respect to the amount of contributions or benefits, but also with respect to the availability of optional forms of benefit and other benefits, rights, and plan features such as actuarial assumptions, loans, Social Security supplements, and disability benefits. Specific requirements regarding the general non-discrimination rule are set forth in Treasury regulations.

d. Nondiscrimination rules relating to qualified cash or deferred arrangements

In general

A profit-sharing or stock bonus plan, a pre-ERISA money purchase pension plan, or a rural cooperative plan may include a qualified cash or deferred arrangement (sec. 401(k)). Under such an arrangement, 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 can be made by an individual is $7,000 (indexed) ($10,000 for 1999). A special nondiscrimination test applies to cash or deferred arrangements.[7]

The special nondiscrimination test applicable to elective deferrals under qualified cash or deferred arrangements is satisfied if the actual deferral percentage for eligible highly compensated employees for a plan year is equal to or less than either (1) 125 percent of the actual deferral percentage of all nonhighly compensated employees eligible to defer under the arrangement, or (2) the lesser of 200 percent of the actual deferral percentage of all eligible nonhighly compensated employees or the actual deferral percentage for all eligible nonhighly compensated employees plus 2 percentage points. The actual deferral percentage for a group of employees is the average of the ratios (calculated separately for each employee in the group) of the contributions paid to the plan on behalf of the employee to the employee's compensation. The maximum permitted actual deferral percentage for highly compensated employees for a year is generally determined by reference to the actual deferral percentage for nonhighly compensated employees for the preceding year. Certain employer matching and nonelective contributions may be used to satisfy the special nondiscrimination test.

If a cash or deferred arrangement satisfies the special nondiscrimination test, it is treated as satisfying the general nondiscrimination rules (sec. 401(a)(4)) with respect to the amount of elective deferrals. However, the group of employees eligible to participate in the arrangement is still required to satisfy the minimum coverage test (sec. 410(b)).

Excess contributions

If the special nondiscrimination rules are not satisfied for any year, the qualified cash or deferred arrangement will not be disqualified if the excess contributions (plus income allocable to the excess contributions) are distributed before the close of the following plan year. In addition, under Treasury regulations, instead of receiving an actual distribution of excess contributions, an employee may elect to have the excess contributions treated as an amount

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[7] State and local governments generally are precluded from maintaining section 401(k) plans. However, they generally can maintain other types of plans (such as section 403(b) annuities, in the case of educational organizations, or section 457 plans) which operate in a similar manner.

distributed to the employee and then contributed by the employee to the plan on an after-tax basis.

Excise tax on excess contributions

An excise tax is imposed on the employer making excess contributions to a qualified cash or deferred arrangement (sec. 4979). The tax is equal to 10 percent of the excess contributions (but not earnings on those contributions) under the arrangement for the plan year ending in the taxable year. However, the tax does not apply to any excess contributions that, together with income allocable to the excess contributions, are distributed or, in accordance with Treasury regulations, recharacterized as after-tax employee contributions no later than 2-1/2 months after the close of the plan year to which the excess contributions relate.

Design-based safe harbor

Effective for years beginning after December 31, 1998, as an alternative to the special nondiscrimination test, a cash or deferred arrangement may satisfy a designed-based safe harbor. The designed-based safe harbor was added by the Small Business Job Protection Act of 1996. The Congress believed that the complexity of the special nondiscrimination test was not justified by the marginal additional participation of rank-and-file employees that might be achieved by the operation of the rule, particularly given the dollar limit on elective deferrals. It was believed that the result the nondiscrimination test was intended to produce could also be achieved by creating an incentive for employers to provide certain matching contributions or nonelective contributions on behalf of rank-and-file employees. It was also hoped that the significant reduction in administrative burdens under a design-based test would encourage more employers, particularly small employers, to adopt a plan. Critics of the design-based safe harbor are concerned that it will significantly reduce participation by rank-and-file employees.

Under the safe harbor rule, a plan satisfies the contribution requirements for a cash or deferred arrangement if the employer either (1) satisfies certain matching contribution requirements or (2) makes a nonelective contributions 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 whether the employee makes elective contributions under the arrangement. In addition, under the safe harbor rule, the plan must satisfy a notice requirement. The notice requirement is satisfied if each employee eligible to participate in the cash or deferred arrangement is given written notice, within a reasonable period before any year (or, in the year an employee becomes eligible, within a reasonable period before the employee becomes eligible), of the employee's rights and obligations under the arrangement.

e. Nondiscrimination rules relating to employer matching contributions and employee contributions

In general

A special nondiscrimination test is applied to employer matching contributions and after-tax employee contributions under qualified defined contribution plans (sec. 401(m)).[8] This special nondiscrimination test is similar to the special nondiscrimination test applicable to qualified cash or deferred arrangements. Contributions which satisfy the special nondiscrimination test are treated as satisfying the general nondiscrimination rules (sec. 401(a)(4)) with respect to the amount of contributions.

The term "employer matching contributions" means any employer contribution made on account of (1) an employee contribution or (2) an elective deferral under a qualified cash or deferred arrangement.

The special nondiscrimination test is satisfied for a plan year if the actual contribution percentage for eligible highly compensated employees does not exceed the greater of (1) 125 percent of the actual contribution percentage for all other eligible employees, or (2) the lesser of 200 percent of the actual contribution percentage for all other eligible employees, or such percentage plus 2 percentage points. The contribution percentage for a group of employees for a plan year is the average of the ratios (calculated separately for each employee in the group) of the sum of matching and employee contributions on behalf of each such employee to the employee's compensation for the year.

Effective for years beginning after December 31, 1998, as an alternative to the special nondiscrimination test applicable to employer matching contributions, a plan may satisfy a designed-based safe harbor. Under the safe harbor, a plan is treated as meeting the special nondiscrimination test if (1) the plan meets the contribution and notice requirements applicable under the safe harbor method of satisfying the special nondiscrimination requirement for qualified cash or deferred arrangements, and (2) the plan satisfies a special limitation on matching contributions.

Treatment of excess aggregate contributions

As under the rules relating to qualified cash or deferred arrangements, if the special nondiscrimination test is not satisfied for any year, the plan will not be disqualified if the excess aggregate contributions (plus income allocable to such excess aggregate contributions) are distributed (or, if not vested, forfeited) before the close of the following plan year. Generally, the

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[8] These rules also apply to certain employee contributions to a defined benefit pension plan.

amount of excess aggregate contributions and their allocation to highly compensated employees is determined in the same manner as with respect to excess deferrals.

Excise tax on excess aggregate contributions

An excise tax is imposed on the employer with respect to excess aggregate contributions (sec. 4979). The tax is equal to 10 percent of the excess aggregate contributions (but not earnings on those contributions) under the plan for the plan year ending in the taxable year for which the contributions are made.

However, the tax does not apply to any excess aggregate contributions that, together with income allocable to the excess aggregate contributions, are distributed (or, if nonvested, forfeited) no later than 2-1/2 months after the close of the plan year in which the excess aggregate contributions arose.

2. Limitations on contributions and benefits

In general

Under present law, overall limits are provided on contributions and benefits under qualified plans based on the type of plan (sec. 415). The overall limits apply to all such contributions and benefits provided to an individual by any one private or public employer. Certain special rules apply to governmental plans which allow higher benefits to be paid under governmental defined benefit plans.

Defined contribution plans

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) $30,000 (sec. 415(c)). 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 $30,000 limit is indexed for cost-of-living adjustments. Compensation for these purposes generally includes all compensation includible in gross income. Elective deferrals to section 401(k) plans and similar arrangements, elective contributions to nonqualified deferred compensation plans of tax-exempt employers and State and local government plans (sec. 457 plans), and salary reduction contributions to a cafeteria plan are also considered compensation.

Defined benefit pension plans

In general

Under present law, the limit on the annual benefit payable by a defined benefit pension plan is generally the lesser of (1) 100 percent of average compensation, or (2) $130,000 for 1999 (sec. 415(b)).[9] All defined benefit plans of the employer are aggregated for purposes of this limit. The dollar limit is adjusted annually for cost-of-living increases. The dollar limit is reduced proportionately for individuals with less than 10 years of participation in the plan. The compensation limit is reduced proportionately for individuals with less than 10 years of participation in the plan.

The dollar limit on annual benefits is reduced if benefits under the plan begin before the Social Security retirement age so that the limit is actuarially equivalent to a benefit beginning at the Social Security retirement age. If retirement benefits provided by a defined benefit pension plan begin after the Social Security retirement age, the dollar limit is increased so that it is the actuarial equivalent of the dollar limit applicable to a benefit beginning at the Social Security retirement age.

Present law provides that a minimum benefit can be paid even if the benefit exceeds the normally applicable benefit limitations. Thus, the overall limits on benefits are deemed to be satisfied if the retirement benefit of a participant under all defined benefit pension plans of the employer does not exceed $10,000 for a year or any prior year, and the participant has not participated in a defined contribution plan of the employer. The $10,000 limit is reduced for participants with less than 10 years of service with the employer.

Combined plan limitation

An additional limitation applies if an employee participates in a defined benefit pension plan and a defined contribution plan maintained by the same employer. This combined plan limitation prevents avoidance of the separate plan limits through the creation of different types of plans. The limit permits an employee to obtain benefits greater than the single-plan limitation, but precludes an individual from obtaining the maximum possible benefits from both a defined contribution plan and a defined benefit pension plan of the same employer. Effective for years beginning after December 31, 1999, the combined plan limitation is repealed.

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[9] Annual benefits may in some cases exceed this dollar limitation under grandfather and transition rules contained in the Tax Equity and Fiscal Responsibility Act of 1982 and other legislation.

3. Definitions

a. Highly compensated employee

In general

For purposes of the qualification rules, an employee, including a self-employed individual, is treated as highly compensated with respect to a year if the employee (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 $80,000 (indexed for inflation) or (b) at the election of the employer had compensation in excess of $80,000 (indexed for inflation) and was in the top 20 percent of employees by compensation for such year.

Treatment of family members

Prior to 1997, a special rule applied with respect to the treatment of family members of certain highly compensated employees. Under the special rule, if an employee was a family member of either a 5-percent owner or 1 of the top 10 highly compensated employees by compensation, then any compensation paid to such family member and any contribution or benefit under the plan on behalf of such family member was aggregated with the compensation paid and contributions or benefits on behalf of the 5-percent owner or the highly compensated employee in the top 10 employees by compensation. Therefore, such family member and employee were treated as a single highly compensated employee. Effective for years beginning after 1996, the family aggregation rules have been repealed. The rules were repealed by the Small Business Job Protection Act of 1986 because the Congress believed the rules imposed an undue restriction on the ability of family members to obtain retirement benefits. In addition, the complexity of the calculations required under the rules appeared unnecessary in light of the numerous other provisions that ensured that pension plans do not unduly benefit highly compensated employees.

b. Employer and employee

In general

For purposes of plan qualification requirements, all employees of certain entities must be aggregated and treated as though employed by a single employer. Under these rules, all employees are considered employed by the same entity to the extent they are employed by corporations that are members of a controlled group (sec. 414(b)), trades or businesses under common control (e.g., related partnerships) (sec. 414(c)), or members of an affiliated service group (sec. 414(m)). In addition, individuals are treated as employees to the extent they are leased employees (sec. 414(n)). The Secretary of the Treasury is authorized to prescribe by regulations such additional aggregation rules as are necessary to prevent the avoidance of the qualification rules through the use of separate organizations, employee leasing, or other arrangements (sec. 414(o)).

Leased employees

An individual (a leased employee) who performs services for another person (the recipient) may be treated as the recipient's employee if the services are performed pursuant to an agreement between the recipient and a third person (the leasing organization) who is otherwise treated as the individual's employer. The individual is to be treated as the recipient's employee only if the individual has performed services for the recipient on a substantially full-time basis (i.e., at least 1500 hours) for a period of at least 12 months, and the services are of a type historically performed by employees in the recipient's business field.

An individual who otherwise would be treated as a recipient's leased employee will not be treated as such an employee if the individual participates in a safe harbor plan maintained by the leasing organization. A plan is a safe harbor plan if it is a money purchase pension plan and if it provides that (1) an individual is a plan participant on the first day on which the individual becomes an employee of an employer maintaining the plan, (2) each employee's rights to or derived from employer contributions under the plan are nonforfeitable at the time the contributions are made, and (3) amounts are to be contributed by the employer on behalf of an employee at a rate not less than 10 percent of the employee's compensation for the year (the 10 percent contribution is not to be reduced by integration with Social Security).

Each leased employee is to be treated as an employee of the recipient, regardless of the existence of a safe-harbor plan, if more than 20 percent of an employer's nonhighly compensated workforce are leased employees.

4. Sanctions for failure to meet qualification rules

If a plan fails to meet the qualification standards, then the special tax benefits for qualified plans do not apply, and benefits and contributions are taxed under normal income tax rules. In general, if a plan fails to meet the qualification standards, then contributions to the plan are includible in the employees' gross income when such contributions are no longer subject to a substantial risk of forfeiture (secs. 402(b) and 83). Amounts actually distributed or made available to an employee are generally includible in income in the year distributed or made available under the rules applicable to taxation of annuities (sec. 72). An employer is generally not entitled to a deduction for contributions to a nonqualified plan until the contributions are includible in an employee's gross income.

A special sanction applies to violations of the minimum participation rule and the minimum coverage rules. Under this sanction, if one of the reasons a plan fails to be a qualified plan is because it fails either the coverage rules or the minimum participation rule, then highly compensated employees are to include in income the value of their vested accrued benefit as of the close of the year in which the plan fails to qualify. Nonhighly compensated employees are not taxed on their benefits if the only reason a plan is not a qualified plan is a failure to satisfy the coverage requirements or the minimum participation rule.

Because disqualification of a plan can have harsh results, in practice, the Internal Revenue Service ("IRS") generally does not disqualify a plan for failure to satisfy the qualification rules, but negotiates lesser sanctions if the qualification failure is corrected. The IRS has established programs allowing plan sponsors to correct qualification failures and thereby continue to provide their employees with retirement benefits on a tax-favored basis. These programs include: the Administrative Policy regarding Self-Correction ("APRSC"); the Voluntary Compliance Resolution ("VCR") program; the Walk-in Closing Agreement Program ("Walk-in CAP"); and the Audit Closing Agreement Program ("Audit CAP"). Recently, the IRS consolidated these programs into a coordinated Employee Plans Compliance Resolution System ("EPCRS").

C. Treatment of Distributions

1. Uniform minimum distribution rules

Present law provides uniform minimum distribution rules generally applicable to all types of tax-favored retirement vehicles, including qualified plans and annuities, individual retirement arrangements ("IRAs"), and tax-sheltered annuities.

Under present law, distributions from qualified plans are required to begin no later than the participant's required beginning date (sec. 401(a)(9)). The required beginning date means 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. In the case of an employee who is a 5-percent owner (as defined in section 416), the required beginning date is the April 1 of the calendar year following the calendar year the employee attains age 70-1/2. Distributions after the participant's death also must meet certain minimum distribution requirements.[10]

Under present law, the sanction for failure to make a minimum required distribution to an employee (or other payee) under a qualified retirement plan is a 50-percent nondeductible excise tax on the excess in any taxable year of the amount required to have been distributed under the minimum distribution rules, over the amount that actually was distributed (sec. 4974). The tax is imposed on the individual required to take the distribution. However, a plan will not satisfy the applicable qualification requirements unless it expressly provides that, in all events, distributions under the plan are to satisfy the minimum distribution requirements.

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[10] Roth IRAs are not subject to the pre-death minimum distribution rules.

2. Withdrawal rules

Present law limits the circumstances under which plan participants may obtain preretirement withdrawals from a qualified plan. In general, these restrictions recognize that qualified plans are intended to provide retirement income.

The least restrictive withdrawal rules apply to profit-sharing and stock bonus plans. Amounts may generally be withdrawn from such plans after they have been in the plan for 2 years. Distributions before the expiration of such 2-year period may also be made in the event of retirement, death, disability, other separation from service, or hardship.

Distributions from qualified pension plans (i.e., defined benefit pension plans and money purchase pension plans) may generally be made only in the event of retirement, death, disability, or other severance from employment.

Special rules apply to section 401(k) plans. Elective deferrals under a qualified cash or deferred arrangement (and earnings thereon) may only be distributed on account of separation from service, death, or disability, or attainment of age 59-1/2. Elective deferrals (but not earnings thereon) may also be distributed on account of a hardship of the employee.

3. Taxation of distributions

In general

Under present law, a distribution of benefits from a tax-favored retirement arrangement generally is includible in gross income in the year it is paid or distributed under the rules relating to taxation of annuities. Thus, any amount distributed is includible in gross income except to the extent the amount distributed represents the employee's investment in the contract (i.e., basis) (secs. 72 and 402). Special rules apply in the case of certain lump-sum distributions from a qualified plan,[11] distributions that are rolled over to an IRA or another qualified plan, and distributions of employer securities.

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[11] The special treatment of lump-sum distributions has been generally repealed. Under a grandfather rule, some taxpayers may be permitted to make an election with respect to a lump-sum distribution to use income averaging or other special tax treatment. In general, a lump-sum distribution is a distribution within one taxable year of the balance to the credit of an employee which becomes payable to the recipient (1) on account of the death of the employee, (2) after the employee attains age 59-1/2, (3) on account of the employee's separation from service, or (4) in the case of self-employed individuals, on account of disability. In addition, a distribution to an employee is treated as a lump-sum distribution only if the employee has been a participant in the plan for at least 5 years before the year of the distribution.

Distributions before age 59-1/2 from qualified plans and other tax-favored retirement vehicles are subject to an additional 10-percent income tax (sec. 72(t)), unless an exception applies.

Rollovers

Under present law, an "eligible rollover distribution" may be rolled over tax free to certain IRAs or another qualified plan or annuity. 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 trust, 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, and (2) any distribution to the extent such distribution is required under the minimum distribution rules.

The maximum amount of a distribution that can be rolled over is the amount of the distribution that is taxable. That is, employee contributions cannot be rolled over. The rollover must be made within 60 days after the distribution was received.

A plan must provide that employees have the option to elect to have an eligible rollover distribution transferred directly to an IRA or another qualified plan. If the employee elects not to make such a transfer, then the distribution is subject to withholding at a flat rate of 20 percent.

The rollover rules are designed to encourage individuals to preserve their qualified plan benefits in a tax-favored vehicle until retirement.

Deferral of tax on net unrealized appreciation

Under present law, a taxpayer is not required to include in gross income amounts received in the form of a lump-sum distribution to the extent that the amounts are attributable to net unrealized appreciation in employer securities. Such unrealized appreciation is includible in gross income when the securities are disposed of in a taxable transaction.

In addition, gross income does not include net unrealized appreciation on employer securities attributable to after-tax employee contributions, regardless of whether the securities are received in a lump-sum distribution. Such appreciation is includible in income when the securities are disposed of in a taxable transaction.

D. Funding Rules

Under the Code, certain defined benefit pension plans and money purchase pension plans are required to meet a minimum funding standard for each plan year (sec. 412). The minimum funding standards are designed to ensure that pension plans have sufficient assets to pay benefits.

In the case of a money purchase pension plan, the contribution required by the minimum funding standard is generally the contribution rate specified by the plan. A defined benefit pension plan is funded using one of a number of acceptable actuarial cost methods. A special funding rule that requires faster funding applies to underfunded single-employer defined benefit pension plans.

No contribution is required or permitted under the minimum funding rules to the extent the plan is at the full funding limitation. In addition, under present law, subject to certain limitations, an employer may make deductible contributions to a defined benefit pension plan up to the full funding limitation. The full funding limitation 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) 155 percent[12] of the plan's current liability, over (2) the lesser of (a) the fair market value of the plan's assets, or (b) the actuarial value of the plan's assets (sec. 412(c)(7)).

[12] The current liability full funding limit as originally enacted was 150 percent of current liability. Under the Taxpayer Relief Act of 1997, the current liability full funding limit was increased to 155 percent in 1999. It increases again as follows: 160 percent for 2001 and 2002; 165 percent for 2003 and 2004, and 170 percent for 2005 and thereafter.

III. ISSUES AND ANALYSIS RELATING TO THE SIMPLIFICATION OF EMPLOYEE PENSION BENEFITS TAX LAWS

In general

There are three potential sources of income for an individual after retirement–Social Security benefits, employer-provided retirement plan benefits, and personal savings. These three sources of retirement income have traditionally been referred to as the "three-legged stool" for providing retirement income security. Taken together, these three sources of income ideally should provide an adequate replacement for preretirement income.

An employer's decision to establish or continue a pension plan for employees is voluntary. The Federal tax laws provide favorable tax treatment for amounts contributed to an employer-provided pension plan to encourage the establishment and continuance of such plans.

The Federal laws and regulations governing employer-provided retirement benefits are recognized as among the most complex set of rules applicable to any area of the tax law. Some have argued that this complexity has made it difficult, if not impossible, for employers, particularly small employers, to comply with the law. In addition, it is asserted that this complexity deters employers from establishing pension plans or forces the termination of such plans. If this assertion is accurate, then the complexity of the employee benefits laws is reducing the number of employees covered under employer-provided plans. Such a result then forces Social Security and personal savings to assume more of the burden of replacing preretirement income.

Others assert that the complexity of employee benefits laws and regulations is a necessary by-product of attempts to (1) ensure that retirement benefits are delivered to more than just the most highly compensated employees of an employer, (2) provide employers, particularly large employers, with the flexibility needed to recognize the differences in the way that employers do business, and (3) ensure that retirement benefits generally are used for retirement purposes.

A brief discussion follows of the reasons for complexity in the pension area.

Reasons for complexity in employee pension benefits laws

Volume and frequency of employee benefits legislation

Many employers and practitioners in the pension area have argued that the volume of legislation affecting pension plans enacted since 1974 has contributed to complexity. In many cases, a particular substantive area of pension law may be dealt with legislatively every year. For example, the rules relating to the form and taxation of distributions from qualified pension plans were significantly changed by the Tax Equity and Fiscal Responsibility Act of 1982, the Deficit Reduction Act of 1984, the Tax Reform Act of 1986, the Unemployment Compensation Act of

1992, the Small Business Job Protection Act of 1996, and the Taxpayer Relief Act of 1997. In many cases, changes in the rules are lobbied for by employers and practitioners.

This constant change of the law has not only contributed to complexity for the employer, plan administrator, or practitioner who must understand the rules, but has also created problems for the IRS and Department of Labor. Employers may not know what they must do to bring their pension plans into compliance with enacted legislative changes because the IRS has been unable to publish adequate guidance for employers.

The amount of legislation in the pension area in recent years hinders the ability of the IRS and the Department of Labor to monitor compliance with the law. Significant amounts of resources are required to be expended to educate government employees with respect to changes in the law. Time that is spent reviewing pension plan documents to determine whether they qualify under the tax laws in form takes time away from the auditing of plans to ensure that they qualify in operation.

The level of legislative and regulatory activity in the pension area has also created problems because inadequate time is available to consider the possible interaction of various provisions. The IRS may issue regulations that are immediately superseded by legislation. Legislation may be enacted that does not consider the potential interaction problems created with other areas of employee benefits law.

Some people argue that the rules relating to employer-provided pension plans should not be significantly altered in the context of an effort to simplify the rules. This argument assumes that additional changes in the employee benefits area will only contribute to complexity by legislating again in an area that some say has been over legislated in the last 10 years.

On the other hand, legislative initiatives that merely repeal existing rules may not contribute to additional complexity of the rules unless the repeal of such rules leaves uncertainty as to the rule that applies in place of the repealed rule.

The structure of the workplace

Some argue that the complexity of the rules relating to pensions stems from a problem that is not unique to the employee benefits area--that is, the way in which the workplace has developed has created inherent complexities in the way that legislation is enacted. The way in which employers do business affects the complexity of pension legislation.

Large employers tend to have complex structures. These complex structures may include the division of employees among various subsidiaries that are engaged in different types of businesses. Rules are required to deal with the issues that arise because a business is operated in many tiers. For example, questions arise as to which employees are required to be taken into account in determining whether an employer is providing pension benefits on a nondiscriminatory basis. To what extent are employees of various subsidiaries that are engaged in completely different activities required to be aggregated? If these employees must be aggregated for testing purposes, what kind of recordkeeping burdens are imposed on the employer? How are headquarters employees treated and how does the treatment of such employees differ from the treatment of subsidiary employees? If an employer retains temporary workers, to what extent are such workers required to be taken into account? Should employees covered by collective bargaining agreements be treated differently than other employees? Employers face these issues every day because of the way in which their businesses are operated, rather than simply because the laws governing pension benefits are complex.

Flexibility and complexity

Employers and employees generally want to be able to tailor their compensation arrangements, including pension benefits, to fit their particular goals and circumstances. Present law accommodates these desires by providing for various tax-favored retirement savings vehicles, including qualified plans, individual retirement arrangements ("IRAs"), simplified employee pensions ("SEPs"), SIMPLE plans, and tax-sheltered annuities. There are many different types of qualified plans, different ways of funding such plans, and different ways of providing benefits under such plans.

The number of different tax-favored retirement arrangements increases complexity in the pension rules because different rules are needed for each type of arrangement. A great deal of simplicity could be achieved, for example, if employers were permitted to choose from only one or two model pension plans. However, this would also greatly reduce the flexibility provided employers and employees under present law.

To some extent, the complexity of present law is elective. For example, employers who wish to reduce complexity can adopt a master or prototype plan. Similarly, an employer may adopt a simple profit-sharing plan for all his employees that involves a minimum of administrative work. However, many employers choose more complicated compensation arrangements.

Complexity and certainty

Although employers and practitioners often complain about the complexity of the rules relating to employer-provided pension plans, some of that complexity is, in fact, attributable to the desire of employers or the Congress to have certainty in the rules. For example, the general nondiscrimination rule relating to qualified pension plans merely requires that a plan not discriminate in either contributions or benefits in favor of highly compensated employees. This rule is easy to articulate; however, determining whether or not the rule is satisfied is not a simple task. The most obvious problem is determining what the word "discriminate" means. If it means that there can be no difference in contributions or benefits between those provided to highly compensated employees and those provided to rank-and-file employees, then the rule may be fairly straightforward. However, because the rules permit employers some flexibility to provide more contributions or benefits for highly compensated employees, then it is necessary to determine how much of a difference in the contributions or benefits is permitted.

On the other hand, rules that provide greater certainty for employers tend, on their face, to appear to be more complex. The nondiscrimination rules for employee benefits added in the Tax Reform Act of 1986 (Code sec. 89) are a case in point.[13] Employers complained vigorously about the calculations and recordkeeping requirements imposed by section 89. However, these rules developed during the legislative consideration of the 1986 Act were in large measure in response to employer's complaints about the uncertainty of a general rule prohibiting nondiscrimination in favor of highly compensated employees.

A more mechanical rule will often appear to be more complex, but will also provide more certainty to the employers, plan administrators, and practitioners who are required to comply with the rule. Thus, any attempts to reduce complexity of the employee benefits laws must balance the desire for simplicity against the perceived need for certainty. In addition, it should be recognized that simplicity in legislation does not preclude complexity in regulation.

Retirement policy vs. tax policy

A source of complexity in the development of pension laws and regulations occurs because the Federal Government has chosen to encourage the delivery of retirement benefits by employers through the Federal income tax system. This decision tends to create conflicts between retirement income policy and tax policy.

Retirement income policy has as its goal the delivery of adequate retirement benefits to the broadest possible class of workers. Because the decision to maintain a retirement plan for employees is voluntary, retirement income policy would argue for laws and regulations that do not unduly hinder the ability or the willingness of an employer to establish a retirement plan. Such a policy might also encourage the delivery of more retirement benefits to rank-and-file employees by adopting a rule that prohibits discrimination in favor of highly compensated employees, but does not otherwise limit the amount of benefits that can be provided to such employees. Thus, an employer whose principal objective was to provide large retirement benefits to highly compensated employees (e.g., management) could do so as long as the employer also provided benefits to rank-and-file employees.

On the other hand, tax policy will be concerned not only with the amount of retirement benefits being delivered to rank-and-file employees, but also with the extent to which the Federal Government is subsidizing the delivery of such benefits. Thus, Federal tax policy requires a balancing of the tax benefits provided to an employer who maintains a qualified plan in relation to all other tax subsidies provided by the Federal tax laws. This balancing has led the Congress

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[13] The rules of section 89 were repealed in 1989. (P.L. 101-140).

(1) to limit the total amount of benefits that may be provided to any one employee by a qualified plan and (2) to adopt strict nondiscrimination rules to prevent highly compensated employees from receiving a disproportionate amount of the tax subsidy provided with respect to qualified pension plans.

Jurisdiction of pension legislation

When ERISA was enacted in 1974, the Congress concluded that Federal pension legislation should be developed in a manner that limited the Federal tax subsidy of employer-provided retirement benefits and that provided adequate safeguards for the rights of employees whose employers maintained pension plans. Accordingly, the rules adopted in ERISA included changes in the tax laws governing qualified plans (Title II of ERISA) and also included labor law requirements applicable to employer-provided plans (Title I of ERISA). In many cases, these labor law requirements mirrored the requirements of the tax laws and created a civil right of action for employees. Thus, ERISA ensured that compliance with the Federal employee benefits laws could be monitored by the Federal Government (through the IRS and the Department of Labor) and by employees (through their civil right of action under the labor laws).

Although many of the pension laws enacted in ERISA had mirror provisions in the labor laws and in the Internal Revenue Code, subsequent legislation has not always followed the same form. For example, the top-heavy rules that were enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982 were only included in the Internal Revenue Code and did not contain a corresponding provision in Title I of ERISA. Some have argued that such a piecemeal approach to employee benefits legislation can lead to inconsistencies between the Federal tax law and Federal labor law and can contribute to the overall complexity of the rules governing pension plans.

In addition, the enforcement of rules relating to employer-provided pension plans is shared by the IRS and the Department of Labor. Thus, there is no single agency of the Federal Government that is charged with the development and implementation of regulations and with the operational enforcement of the rules relating to pension plans.

Although the authority of each applicable agency has been clarified, complexity can occur because of the manner in which the agencies interact. An employer must determine the agency with which it must consult on an issue and may find that the goals of each agency are different. For example, the Pension Benefit Guaranty Corporation (PBGC) views the funding of a defined benefit pension plan from its goal of assuring solvency of the plan when benefit payments are due. On the other hand, the IRS is concerned that employers should not be permitted to overfund defined benefit pension plans as a mechanism by which the employer can shelter income from taxation. Without careful coordination of the goals of these two Federal agencies, employers may receive inconsistent directives.

Transition rules

When the Congress enacts tax legislation altering the tax treatment of qualified pension plans or distributions from such plans, transition relief is often provided to specific employers or individual taxpayers or to a class of employers or taxpayers. Transition relief generally delays temporarily or permanently the application of the enacted rule to the applicable taxpayer. Sometimes, transition relief will apply a modified rule that is a compromise between present law and the enacted rule.

The adoption of transition rules for a taxpayer or a class of taxpayers contributes to the actual and perceived complexity of employee benefits laws.